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May 1991 (First of Two May Issues)

THE STATE FISCAL CRISIS

Introduction: State fiscal problems are now dominating decisionmaking in practically every major field of state activity. Not every state is experiencing shortfalls, but 30 are, according to a recent survey. Those that aren't are generally smaller Western states. Even in states without major shortfalls, resources are tight enough to create major clashes over their use as indicated by a state employee strike in Montana and a teacher strike in Washington.

Timing Of Decisions: The fiscal policies of many states are unusually uncertain this year. In most years in most states, these decisions are predictable in the spring even if not made formally until later. This year, in many states, there is uncertainty about the magnitude of tax increases (or whether there will be increases), what taxes will be raised and, thus, what spending will be. The spending uncertainty means uncertainty about aid to local governments, tuition, employee pay, teacher pay, the extent of Medicaid coverage, Medicaid reimbursement rates, and the operating budgets of agencies.

The details are complex, but the overall problem is easily understood. Legislators don't want to vote for tax increases needed to sustain the spending they prefer and don't want to vote for spending cuts to fit with the level of taxes they are willing to support.

This uncertainty affects larger states including California, Massachusetts, Michigan, Minnesota, New York, Pennsylvania, Tennessee, and Texas. It affects some smaller ones such as Connecticut, Kansas, and Maine. In some of these cases, it is unlikely that legislatures will act before July 1. Some of the decision postponements are already clear. New York has passed the April 1 beginning of the fiscal year without decision. Texas legislative leaders and the governor have agreed to act on taxes and the budget in a July special session rather than the regular session. Tennessee seems to be on a schedule that will result in the showdown on the governor's proposed income tax in the fall rather than in the regular session. California's governor suggested the legislature make fiscal decisions before May 1 to permit spending and tax changes to be in effect for a longer period than possible if enactments were made on the usual schedule, about July first. But May 1 passed without decision.

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Economic Conditions: The National Bureau of Economic Research, the organization whose definition of recession is generally followed, has announced the nation is in a recession which began in July. The typical post-World War II recession has lasted 12 months. The longest were the 16 months of recession experienced in 1973-1975 and again in 1981-1982. Twelve months would make the recession completely congruent with FY 1991 in 46 states. Explicitly or implicitly, all of the state FY 1992 revenue estimates reflect a guess of when recession will end.

The Commerce Department late April GNP estimates indicated the nation has experienced two consecutive quarters of decline in real gross national product -- the shorthand definition of recession. The Commerce data confirm real GNP declines of 1.6% in the last quarter of 1990 and 2.8% in this year's first quarter.

An April survey by the National Conference of State Legislatures found total FY 1991 state budget shortfalls of $11.8 billion in the 30 states reporting shortfalls. This is more than was raised by state tax increases through legislative actions last year. To make it up, states would have to extract a one-time payment of about $100 from every worker in America.

Deficits were confirmed when the Commerce Department released the summary estimates of state and local finances that are a part of national GNP estimates. The deficit for all state and local governments (stated at an annual rate excluding retirement funds) was $44 billion in the fourth quarter of 1990. During the first three quarters, the deficit was about $30 billion while it was $20 billion for CY 1989.

According to the Commerce estimates, which are subject to revision, from CY 1989 to CY 1990, total state and local receipts increased 6.8%. Property taxes grew by 7.3%, more than other major taxes. Sales tax receipts were up 6.1%. Personal income tax revenue rose only 4.4%, while corporate income taxes declined.

Economic Growth: The Index of State Economic Momentum, which last appeared in Issue 6, is designed to show success in economic development and economic impacts on state fiscal condition by comparing each state to the national average. It can also be used to track a state's condition over time, though **Reports** hasn't stressed this use. The Providence Journal and Rhode Island Public Expenditure Council have been looking at Rhode Island's performance since the index began in early 1989. This stimulated the development of Table 1, which shows the rankings of selected states in March of 1989, February of 1990, and March of 1991, the latest index.

Table 1: Changing State Economic Momentum

State	Rank Among States 1989	1990	1991	Index Number 1989	1990	1991
Nevada	1	1	1	4.2	4.7	5.8
New Hampshire	2	42	50	2.2	-.8	-2.8
Florida	3	5	7	1.7	1.8	1.5
Washington	4	3	4	1.5	2.5	2.2
California	8	14	11	.9	.8	1.1
Massachusetts	18	45	48	.3	-1.2	-2.4
Georgia	20	26	23	.2	-.2	0
National Average	-	-	-	0	0	0
New Jersey	22	35	40	-.1	-.5	-1.1
Ohio	25	27	21	-.2	-.3	.1
New York	27	38	36	-.4	-.6	-.8
Pennsylvania	28	41	35	-.4	-.7	-.8
Illinois	34	30	43	-.7	-.3	-1.1
Texas	38	24	12	-.8	-.1	.8

State-By-State Summary: This section summarizes the major fiscal issues in the 13 largest states with 62% of the nation's population. Short summaries miss the nuances of hard-fought issues in each state, but give an impression of the magnitude of the difficulties these states face and what is, and isn't, being done.

Massachusetts remains in more trouble than any other state, as the bond rating agencies and State Budget & Tax News define trouble. Adjusted for changes in tax law, revenues are running below levels of a year earlier. Over the past year, there has been a 5.5% drop in employment in Massachusetts compared with a 1.2% drop nationwide. The new governor (R) is intent on no new taxes, several new tax reductions for business (which he has now decided not to push this year), and repealing the sales tax on services enacted last year, which he achieved earlier this year. His budget-balancing strategy places strong emphasis on one-shot items (see article in this issue) including indirect borrowing, selling assets, and deferring payments to an underfunded pension plan. Legislative leaders (D) are reluctant to accept some of the spending reductions being proposed, unhappy with some of the proposals for one-shot actions, and unwilling to propose tax increases in light of the governors opposition. No compromise is in sight. The impact of the cuts over the past several years has been highly concentrated on higher education and local governments, including elementary and secondary education.

Illinois, Michigan, and Ohio are in unusually good economic shape for a recession. The loss of jobs in Michigan and Ohio over the past year has been below the national average and Illinois has actually gained jobs over the past year. All three states have new Republican governors committed to no new taxes. All three have shortfalls in their current service budgets and required administrative cutbacks to keep the FY 1991 budgets near balance. Their legislatures, which have at least one Democratic-led house, are all considering budget recommendations from governors that cut back current social service programs. Decisions on these budgets won't be made until near the end of the fiscal year, June in Ohio and Illinois and September in Michigan. The pressure for a tax increase will be particularly strong in Michigan, where the current services budget is more out of balance than the other states. To avoid a tax increase, Michigan would need the kind of sharp cutting that may be in store for New Jersey. With an unpopular tax increase from last year, New Jersey elected officials are intent on avoiding a tax increase for any reason. They have already cut back the school aid increases adopted last year, but have considerable controversial cutting to go.

Georgia and Virginia budgets are already set. Virginia's previously enacted FY 1992 budget was cut back in the current legislative session. Most of the adjustments were relatively painless, like using lottery money for operating costs rather than for construction. Georgia profited from a court decision on how a partial food exemption was structured which allowed the legislature comfortably to forget the exemption. Some Florida and North Carolina officials would like to avoid major tax increases also, but will find it difficult to do so without depending upon major local option tax hikes.

Plenty of excitement is in store for those interested in tax policy in Pennsylvania and Texas. With the school finance decision described in this issue, Texas legislators have bought into whopping property tax increases (over $100 per capita) and an unbalanced state budget. They will debate the relative merits of broadening the sales tax base, enacting an income tax, and looking for a way to avoid either alternative. Pennsylvania legislators seem likely to conclude that both the state and local governments, particularly Philadelphia, need more money. A local option sales tax appears the solution for Philadelphia, but the state choice isn't clear. The governor's proposal avoids broad-based taxes by concentration on corporate income and miscellaneous taxes, such as on cigarettes.

National attention on state finances will probably center on California and New York. They are media centers, are the two largest states with 12% and 7.2% of the nation's population, have divided political party control, and present difficult but typical policy issues.

Both states have big budget gaps. In the NCSL shortfall survey, California reported a FY 1991 deficit of $3.6 billion or $121 per capita. This is well above the total for state governments nationwide of about $40-50 per capita, though not approaching the federal government with a deficit of about $1,000 per capita. New York's reported FY $1.15 billion current year shortfall is less, $64 per capita, but doesn't count $4 billion in annual borrowings. The FY 1992 budget gap numbers are even larger, $12-13 billion in California and around $4 billion in New York. These combine the current year shortfall, the gap between current service revenue and spending for FY 1992, and, in California's case, money to replenish reserves.

Governor Cuomo (D) and Governor Wilson (R) have both taken the position that spending is already at excessive levels, so that spending cuts must form a major part of closing the budget gap. Elementary and secondary education is a target. In New York, the governor has recommended a 10% cut and an even greater cut in non-school local aid. In California, Proposition 98 guarantees education the same percentage of the state budget as in the past, a guarantee Governor Wilson says shouldn't be honored. Both governors have recommended tight higher education budgets and substantial tuition increases. Governor Wilson wants cuts in cash benefit levels in welfare. Both governors want a variety of social and health service cuts.

Many legislators in both states are vocally uncomfortable with the proposed cuts. The most publicized concerns come from Democrats, who are in the majority in both bodies in California and the House in New York. But members of both parties recognize the considerable problem associated with outcomes that leave them accountable for raising taxes while cutting aid to schools and local government and not funding significant new initiatives of any kind.

Both governors have proposed tax increases. In California, the initial proposals concentrated on broadening the sales tax base, but the governor has now endorsed upping the sales tax rate. In New York, the cornerstone of the governor's tax plan is a ten-cent increase in the gas tax. Legislative leaders in the New York House and California Senate and House have been urging raising top bracket income tax rates and various other taxes, including many on business.

One-Shots: High reliance on one-time infusions of revenue to balance state budgets is drawing increasing critical comment. Such actions have always been criticized by bond rating agencies and financial experts. Spreading concern is evidenced by a Business Week (5/6) feature subtitled "How State And Local Budgeteers Are Gimmicking Their Way Out Of A Tight Squeeze."

Attention has been drawn in New York by the consistent criticism of the state comptroller, among others. In Massachusetts, where an extraordinary number of one-shot solutions have been used in the past, the newest round of proposals by the governor is being subjected to considerable denunciation in the legislature. Less noticed changes are appearing elsewhere, such as a proposed accounting change in California that forms a major part of the budget-balancing plans proposed by the governor. Business Week contends that Massachusetts, New Jersey, and New York "lead the pack in innovation." But, "also playing the game" are other states such as California, Illinois, and Michigan.

The prime examples: (1) selling state facilities to a state authority and then renting them back (New York) or avoiding rent by having costs recovered in tolls (New Jersey and New York), (2) borrowing money to cover a short term shortfall and paying it back over a long period (Massachusetts), (3) juggling the payback schedules of existing bonds (Massachusetts, proposed), (4) accelerating tax collections (many states), (5) delaying scheduled payments (many states with Illinois a recent example and West Virginia an older one), (6) short-term loans to the general fund from other funds (many states with Texas probably holding the record for the amount involved). These devices aren't new, just being used much more this year.

One new to **Reports** is a practice **Business Week** says is being used by Michigan school districts -- the use of zero coupon bonds without a sinking fund. This means that the entire principal and accumulated interest for a facility comes due as a lump sum 20-30 years after the bonds are issued. The practice would be in violation of state law in most states

One-Shot Solutions: The essence of budgetary one-shots is that they trade a current improvement in finances for a worse outlook for the future. Most one-shots aren't complicated. Selling New York's Attica prison and leasing it back has the same impact as selling your paid-for personal car and then leasing it or a comparable car. Covering past Massachusetts deficits by borrowing is like deciding to cover a bad year by running up the balance on credit card debt. The economics doesn't change when the loan is from the industrial finance authority, which in turn borrows in the marketplace, as proposed by Pennsylvania's governor. The immediate financial improvement is clear, as is the negative impact on the future.

Critics of one-shots have urged that states engage in some sort of financial planning that forces consideration of the negative impacts in future years along with the positive impacts in the budget year. This is one of the arguments for switching from annual to biennial budgets. It is also an argument for maintaining some sort of five or ten year plan.

This concept of a longer time horizon for state decisions is the subject of the new Journal Of State Government (Jan-Mar.). Keon Chi (Council of State Governments) assesses state futures commissions. There have been 31 of these since 1970 with titles like the Oregon 2000 Commission and Commission on the Future of South Carolina. He likes the idea of these groups and expects more use of them in the future. But, "One lesson we can learn from this overview of state foresight projects is that unless state leaders themselves are willing to change the way they make decisions, no guarantees exist that such projects will work." Former Mississippi Governor William Winter concludes: "There must be a willingness on the part of officials to put the long-term public interest ahead of personal political safety." He suggests that this is the best way to restore trust in the political system.

While taking the long view isn't required in many state governments, it is by state-mandated local planning processes in effect in about a fourth of the states. Many of these processes, like those in Florida and Maine, are well along in the local decisionmaking phases. New Jersey's has reached the stage where a state plan will be released after a review and comment stage called "cross acceptance."

The Moratorium On New Initiatives: One result of state fiscal problems is the almost complete absence of major initiatives involving general fund money. This is illustrated by the list of significant initiatives shown in Table 2. Lacking an agreed definition of "new initiatives" or "major," any listing of major new initiatives is arbitrary. **Reports** may have left out one or two major initiatives through ignorance of details of discussions in every state and left out some low cost initiatives, but the overwhelming impression is that new initiatives aren't in the cards in most states. Where they are, the initiatives using general fund money are raising some tax to lower another or funding for education reform.

Table 2: Major New Initiatives Being Considered For FY 1992

State	Initiative	Status
Alaska	Infrastructure, Econ. Development	Pending
Arkansas	Education Quality	Passed
Connecticut	Tax Reform	Pending
Kansas	Education Finance and Tax Reform	Pending
Missouri	Education Quality	Pending
South Dakota	Education Quality	Defeated
Tennessee	Education Quality and Tax Reform	Pending
Texas	School Finance Equalization	Passed

New initiatives not involving general fund money are much more common. Examples are air and water pollution control measures financed by regulatory fees, transportation and other infrastructure projects financed by issuing bonds, and solid waste disposal plans with financing from user charges.

Consent Decrees: As elected officials look for ways to cut state spending patterns, they are constantly encountering consent decrees entered into by their predecessors. One of many examples is provided by Massachusetts. Buffeted by all kinds of fiscal problems and with the lowest bond rating in the nation, the state has a new governor committed to no tax increases. With a shortfall that is as much as 20% of tax revenues, he sees a need for spending cuts such as limits on overtime, closing institutions, layoffs, reductions in payments to vendors, and more. The governor has been pursuing all these alternatives with substantial support in the legislature.

With many people adversely affected, there has been litigation and the threat of litigation in many areas. One major setback to the budget cuts developed in late April when a federal district judge ruled that the state would have to comply with the terms of a consent decree entered into with mental retardation groups 16 years ago. Among other things, the decree requires the state to negotiate any changes of policy (e.g., staffing, payments to providers) with those groups and submit the results for court approval.

Defaults By States? In Forbes (4/29), William Tucker explores, "Is There Such A Thing As Municipal Junk?" He quotes a variety of experts as seeing no default risk associated with municipal bonds of the states and major cities. But he finds others that express some concerns including: (1) uncertainty over whether municipal bond insurers could handle several defaults at once and (2) replacement of cooperative local commercial banks with arms-length mutual funds as the primary purchasers in the tax-exempt bond market.

Statewide Strikes: Roughly 25,000 teachers in Washington State went on strike in late April, closing many schools including those in Seattle and Tacoma. The issue is pending state legislation, specifically the biennial budget. The state doesn't prescribe salaries but provides most of the money spent by local schools and discusses the budget in terms of the salaries it could finance. The governor's proposal was for 4.4%, then 3.8% in the two years of the biennium. The teachers want at least 10%. House and Senate versions of the budget legislation offer slightly less than the governor's version. The teachers are also concerned about the decline in the share of the state budget for education, school construction, textbook and supplies funding, and other issues. Many of the teachers have no-strike clauses in their contracts, but these may not be enforced because some administrators are believed to be in sympathy with the teachers.

Many Montana state employees are operating under a two-year contract that includes the right to strike during the last six months of the contract, a period that began in January. In April, an estimated 5,000 state workers, out of about 14,000, exercised this right. The issue was a 60-cent an hour pay raise that had passed the legislature, was vetoed by the governor, and (the precipitating event) not overridden by the House. The governor favors a pay plan that provides larger raises for professional, higher paid employees rather than a uniform amount for all workers. State facilities remained open, with the National Guard providing some of the staffing at prisons and other state institutions. A compromise on pay ended the walkout.

PAYING FOR HEALTH CARE

State Health Insurance Plans: Former Governor Dukakis is now a visiting professor at the University of Hawaii. In that capacity he recently shared his insights on health care with the editors of the Honolulu Star-Bulletin (3/24). He complemented Hawaii for its unique universal health care law. Because it was passed in the 1970s, it benefits from an exemption from federal law (Employee Retirement Income Security Act) that permits the state to mandate that employers provide coverage. Other states can't mandate coverage, so their proposals rely on taxing employers who fail to provide coverage. Dukakis was a major force in the adoption of the first-on-the-mainland plan in 1988, but its major provisions haven't been implemented. The legislature has been pushing back the effective date. Dukakis told the paper that state-by-state action on universal care isn't the answer on the mainland because of interstate rivalry. He recalled that whenever Massachusetts passed a law providing social benefits, New Hampshire's governor used it to seek to draw businesses to the Granite State.

According to State Health Notes, this is a big year for consideration of state universal health care plans. The publication says at lest 14 states "are debating or, at the very least, studying such plans." This is up from last year when the publication counted such activity in only two states. These conclusions may be true in terms of bills offered, hearings held, and expenditures of time and money by health care providers and other interested parties in talking about the subject. It is emphatically not true in terms of possibilities that any such plans will be enacted.

The plans are running into objections on the merits, which might or might not be sufficient to kill them. They are also running into fiscal problems which might be sufficient to kill them even if there were no objections on the merits.

All the serious plans require new money at the table: (1) taxes on employers to require them to provide coverage or pay for state provision of coverage and (2) state tax money. **Reports** knows of no state where there is serious consideration of either method. The efforts farthest along were Massachusetts (enacted but deferred), Maine (demonstration likely to be deferred), and New Jersey (where support of reasonably united organized labor, many business leaders, health care providers, and state officials wasn't enough).

Who Lacks Health Insurance? There are roughly 34 million Americans who lacked health coverage from private insurance or public programs in 1989. This is 16% of nonelderly Americans. That 16% is up from 12% in 1978, indicating that public policy *has not* reduced the uninsured segment of the population. Of the uninsured, 54.6% were adults with jobs (often with small firms or self employed), 16.7% were adults without jobs, and 28.7% were children. The state-by-state data appear in Table 3.

The table reports what people said about their health coverage in the past year when they were surveyed in early 1990. Because of deteriorating economic conditions since then, the percentage without health coverage today is undoubtedly larger.

Table 3: Percentage of Nonelderly Population Without Health Coverage

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Iowa	8.6%	18	New Jersey	12.3%	34	Idaho	17.6%
2	Michigan	9.7	19	South Dakota	13.1	35	Georgia	17.8
3	Massachusetts	10.0	20	Missouri	13.8	36	Nevada	17.8
4	Hawaii	10.1	21	Washington	13.9	37	South Carolina	17.8
5	Ohio	10.3	22	New York	14.1	38	Delaware	18.2
6	Connecticut	10.4	22	Virginia	14.1	39	Alabama	19.4
6	Utah	10.4	24	Wyoming	14.4	40	Arkansas	20.2
8	Minnesota	10.6	25	Indiana	14.7	41	Mississippi	20.2
9	North Dakota	10.8	26	New Hampshire	15.1	42	Louisiana	20.3
9	Pennsylvania	10.8	27	Tennessee	15.3	43	Arizona	20.7
9	Wisconsin	10.8	28	Kentucky	15.9	44	Florida	21.4
12	Maine	11.0		**United States**	**16.1**	45	California	21.9
13	Kansas	11.3	29	Oregon	16.2	46	Alaska	22.2
14	Illinois	11.5	30	Colorado	16.5	47	Oklahoma	23.8
15	Rhode Island	11.8	31	West Virginia	17.0	48	New Mexico	24.7
16	Maryland	12.0	32	Montana	17.2	49	Texas	25.5
17	Nebraska	12.3	32	North Carolina	17.2	50	Vermont	n.a

The uncovered population in Table 3 counts persons as covered if they were entitled to health services through any public or private coverage. Medicaid coverage reduces the uncovered population shown, just as private coverage does. As a result, there isn't a perfect correlation between the percentage of a state's population that is poor and the percentage that doesn't have health coverage. The percentage of nonelderly reporting Medicaid coverage is shown on Table 4.

Table 4: Percentage of Nonelderly Population With Medicaid Coverage

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Mississippi	14.6%	17	Kentucky	8.6%	34	Nebraska	6.3%
2	Michigan	12.6	17	Pennsylvania	8.6	34	Oklahoma	6.3
3	Louisiana	12.4	19	Georgia	8.1	34	Oregon	6.3
4	California	11.8	20	Ohio	8.0	34	Utah	6.3
5	New York	11.7	21	Rhode Island	7.8	34	Wisconsin	6.3
6	South Dakota	10.3	22	Colorado	7.7	39	New Jersey	6.2
7	Tennessee	10.0	23	Virginia	7.6	40	Iowa	5.6
8	West Virginia	9.7	24	Washington	7.3	40	North Carolina	5.6
9	Alabama	9.6	25	Arizona	7.2	42	Nevada	5.5
10	Illinois	9.5	26	Kansas	7.1	43	Connecticut	2.0
11	Montana	9.4	27	Florida	7.0	44	Alaska	n.a
12	Maine	9.0	28	Minnesota	6.9	45	Delaware	n.a
12	Missouri	9.0	28	South Carolina	6.9	46	Idaho	n.a
14	Massachusetts	8.9	30	Texas	6.8	47	North Dakota	n.a
14	New Mexico	8.9	31	Hawaii	6.7	48	Vermont	n.a
16	Arkansas	8.7	31	Indiana	6.7	49	Wyoming	n.a
	United States	**8.7**	33	Maryland	6.5	50	New Hampshire	n.a

The percentage coverage is an interaction of the generosity of the Medicaid program and the percentage of the population that is low income. Mississippi makes the top of the list on the second point while Michigan makes second place primarily on the first aspect.

THE HOMELESS

The Homeless: The Census Bureau is under attack for a possible undercount of the population in the 1990 Census. The criticism was particularly sharp when the Bureau announced that it had counted 228,621 homeless, an estimate that falls far short of some advocacy group estimates of millions. Not surprisingly, the argument is primarily over the roughly 50,000 said to be on the streets rather than the nearly 200,000 in shelters. Of the total homeless, the largest numbers were counted in California (48,887) and New York (43,204) with no other state having more than 10,000. Relating the counts to population produces the results shown in Table 5.

Table 5: Number Of Homeless Per 10,000 Population, 1990

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Mississippi	1.8	18	Tennessee	4.5	35	Pennsylvania	7.8
2	Arkansas	2.3	19	Alabama	4.7	36	Florida	7.9
3	West Virginia	2.7	20	Virginia	4.8	37	Illinois	8.0
4	South Carolina	3.1	21	North Dakota	4.8	38	Oklahoma	8.1
5	Wisconsin	3.3	22	Missouri	4.8	39	Colorado	8.9
6	Maine	3.4	23	Nebraska	4.9		**United States**	**9.0**
7	New Hampshire	3.4	24	Delaware	5.0	40	Alaska	9.5
8	Iowa	4.1	25	Rhode Island	5.1	41	Washington	10.8
9	Ohio	4.1	26	Idaho	5.3	42	Massachusetts	11.4
10	Louisiana	4.1	27	Texas	5.4	43	New Jersey	11.8
11	Wyoming	4.3	28	Minnesota	5.4	44	Nevada	12.0
12	Kentucky	4.3	29	New Mexico	5.5	45	Arizona	12.6
13	Michigan	4.3	30	Montana	5.7	46	Oregon	13.4
14	North Carolina	4.3	31	Maryland	6.3	47	Connecticut	13.4
15	Vermont	4.4	32	South Dakota	6.7	48	California	16.4
16	Kansas	4.4	33	Georgia	6.7	49	Hawaii	17.3
17	Indiana	4.5	34	Utah	7.0	50	New York	23.9

The states that have been the most active in committing state funds for housing programs and dealing with the homeless have been those hardest hit by current fiscal difficulties. Those programs are facing budget reductions in the entire Northeast. For example, the Connecticut budget would eliminate the state's practice of subsidizing the operating costs of nonprofit housing groups. The Massachusetts fiscal plan would cut off the state's operating subsidy program.

TUITION SETTING

Tuition Increases: In their budgets, many governors have used higher tuition as a mechanism for seeking to balance budgets without raising taxes or cutting back spending. In most states, these recommendations are leading to tuition increases without much controversy in the legislature or the academic world. For example, both houses of the Florida legislature have adopted 10% increases in state university tuition, to $1,300 a year.

Tuition Controversies: The exceptions, however, are significant. In New York, student protests have closed down the City University of New York (CUNY) at several locations. The policy approach in New York was: (1) no tuition increase for about five years, (2) a planned tuition increase in 1989 that was rescinded after student protest, (3) a small increase adopted uneventfully in 1990, and (4) the proposed large increase creating controversy now. This scenario undoubtedly made the increases this year more controversial than they would have been if small annual increases had been used.

In California, there have been tuition increases assumed in each of the last several budgets. In national terms these are small in amount, but large in percentage because California tuition has historically been low -- low enough to be called fees, not tuition, for many years. In Massachusetts, the impact of state budget circumstances on higher education has probably been greater than anywhere else. Tuition will likely have doubled within a four year period before FY 1992 is over.

Tuition As A Budget Balance Wheel: These states illustrate the tendency for state tuition policy to be "jerky," with changing state financial circumstances reflected in allocations to higher education and tuition. When times are good, tuition increases are low or avoided entirely. When times are bad, tuition rockets up as state officials use it as a balancing entry in their budgets. This tendency appeared in the early 1980s, when tuition rose rapidly, and then increased less rapidly late in the decade.

Tuition Formulas: To avoid this, a recent study shows that 16 states use some sort of a formula for setting tuition. The most common pattern is to establish a policy that tuition cover a stipulated percentage (generally 20-35%) of instructional costs. The study concludes that such systems are "neither a panacea or a scourge." They don't seem to drive tuitions higher or lower than they would otherwise be. They don't always guarantee stability, because states can abandon them in a pinch, as Massachusetts is doing.

Out-Of-State Tuition: Fiscal pressures have renewed legislative interest in out-of-state tuition. When state aid levels are set, it is in university administrator's interest to maximize out-of-state students. They provide substantially more tuition income than in-state students, while costing the same amount to educate. In reaction, many states have formal or informal limits on such students. In Florida, the guideline has been 10%, but universities have been running at 11%. The tuition legislation approved by both houses operates in another way, raising the tuition by 24% to $5,700.

Current Tuition Levels: Table 6 illustrates the ranges in state policies on tuition by showing the 1990-1991 academic year in-state tuition for selected state institutions and the extra tuition required from out-of-state residents.

Table 6: FY 1991 Tuition At Selected State Institutions

Institution	Tuition	Out-of-State Surcharge
California State (Fullerton)	$952	$6,150
U. of Texas (Austin)	1,020	3,120
U. of North Carolina (Chapel Hill)	1,059	4,709
U. of Florida	1,322	3,300
City U. of New York (Hunter C.)	1,342	2,800
State U. of New York (Albany)	1,485	3,350
U. of Arizona	1,540	5,006
U. of California (Berkeley)	1,640	5,916
U. of Alabama (Huntsville)	2,019	2,019
U. of Mississippi	2,059	1,182
U. of Colorado (Boulder)	2,097	6,512
Ohio State U.	2,343	4,599
U. of Illinois (Champaign-Urbana)	2,846	3,540
U. of Massachusetts (Amherst)	3,476	4,853
U. of Michigan (Ann Arbor)	3,502	8,508
U. of New Hampshire	3,558	6,080
Pennsylvania State U.	4,048	4,396
U. of Vermont	4,590	8,600

Differing state policies are apparent from the table. California has relatively low tuition for residents, but doesn't share its low tuition policy with non-residents. Institutions with a large potential draw of out-of-state students, like Colorado and Michigan, are expensive for non-residents. But Alabama and Mississippi have relatively low non-resident surcharges. Vermont has high tuition and a high surcharge.

TEXAS SCHOOL FINANCE

Texas School Finance: In mid-April, after several false starts, the Texas legislature passed, and Governor Richards signed, a new school finance law. Legislators were under the gun to reform the existing system which was declared unconstitutional by the state's supreme court. The local judge with jurisdiction over implementation of the court's decision was perceived as likely to cut off all state aid after April 15 if the legislature didn't act. Presented with the new legislation, he agreed not to suspend aid distribution, but did not decide on the constitutionality of the legislation.

The legislation responds to the court's decision that unconstitutional discrimination was involved when students were in districts of unequal wealth and state aid failed to offset the inequalities. In substance, it spreads the property tax wealth, making the poor richer and the rich poorer.

The school bill will provide whopping tax increases in some Texas communities. It mandates a tax rate of 0.72% this fall, which will rise to 1% the following year. The yield of this tax will be given to 188 new taxing units. Their primary function is to create the substance of a statewide property tax -- equalizing wealth among over 1,000 districts -- without violating a constitutional prohibition against such a tax. All districts will be guaranteed a foundation spending level of $2,800 in the second year of the program. In addition, districts can levy additional taxes of 0.45% of value and be guaranteed $21.50 per pupil for each 0.01%, with state aid supplementing the local revenues to achieve this result. More affluent districts will have a strong incentive to levy this amount to maintain current spending patterns. Less affluent ones will have a strong incentive because their state cost sharing will be high. On top of these two tiers of state aid, local districts can levy additional taxes without state equalization payments.

Projections by the state education department, which were not available until after the bill passed, indicated that local taxes would increase by $2.1 billion statewide in the first two years of implementation. This would be $123 per capita, considerably more than estimates when the legislation was passed. At time of passage it was understood that precise cost estimates weren't available, but one figure used for property tax effect was $400 million.

The poorer districts haven't decided on whether to contest the school aid formula further. From a pure equalization perspective, it has a weakness in funding differences above the 1.45% tax level, which the legislature mitigated with a spending cap for rich districts, and in financing school construction. But the result already is strongly equalizing and very expensive. So poor districts may opt to skip further controversy over the formula for now and let attention focus on paying for it. The new school legislation seems to make a state tax increase inevitable. As the Speaker put it, "We're going to have to have some kind of tax bill."

The regular session is expected to end without action on taxes or the budget. There will be a special session in July to consider the budget for the biennium which begins in September. That budget will require substantial new revenue to make the school finance plan work and cover what would have been a gap even without it. By July, there will be special studies of spending (performance audits) available from the Legislative Budget Board and a tax policy report from a blue ribbon commission. In addition to the lieutenant governor's income tax proposal, the Speaker has offered a proposal for raising the sales tax, broadening the sales tax base to services including professional services, and adopting a corporate (but not personal) income tax. The governor is still keeping her options open.

STATE AND LOCAL FINANCE

Arizona Study: The Arizona Fiscal 2000 project was a comprehensive blue ribbon assessment of state fiscal issues based in part on papers prepared by prominent experts throughout the nation. The technical papers were recently published by the School of Public Affairs, Arizona State University (Tempe, AZ 85287) as State And Local Finance For The 1990s: A Case Study Of Arizona. The 483-page volume is heavily oriented to specific conditions in Arizona. This limits its usefulness because some Arizona characteristics -- such as rapid population growth, a health care system that makes it technically the only state without Medicaid, and a small number of strong county governments -- are relatively unique. The chapters most useful to other states are the ones on taxation, many by nationally known experts.

In one chapter, Robert Carroll (U.S. Treasury Department) and Michael Wasylenko (Syracuse U.) find essentially no discernable relationship between state tax policy or state spending and employment growth. They conclude this is because state policies differ little from one state to another. However, they suggest these policies would matter "if a state gets far out-of-line on either taxes or expenditures."

Gold On Balancing Budgets: During the 1980s, Steven Gold served as a fiscal expert for the National Conference of State Legislatures -- traveling coast to coast presenting expert testimony to legislatures and writing prolifically on tax matters with volumes like The State Fiscal Agenda For The 1990s (NCSL, 1990). As NCSL staff, he was precluded from taking sides in individual state controversies. His shift to the State University of New York removed this constraint and created some demand for him to apply his expertise to the Empire State's fiscal problems. So what is he telling New Yorkers to do?

He sees the fiscal problems of state and local governments as permanent phenomena of the 1990s, not temporary ones of 1991. He says many states, including New York, have structural deficits -- "meaning that the spending needed to maintain the current level of services will exceed revenue from the existing tax structure on a continuing basis." He suggests a multi-year plan encompassing both state and local governments.

State-local spending in New York is "bloated" and should be brought down from 45-50% higher per capita than the national average to 25-30%. He finds much of the overspending to be local and proposes reducing state mandates, streamlining local government structure, and overhauling state aid programs that stimulate local spending. Gold is comfortable with Governor Cuomo's proposals for cutting state revenue sharing and school aid. Gold comments, "It is much more vital to have a commitment to restructuring that it is to be generous with school budgets." He also endorses closing some mental hospitals in favor of community programs and raising tuition while increasing scholarships. To stem the rise of corrections costs, he likes revisiting some of the sentencing reform decisions that have caused increased prison spending.

On taxes, Gold warns against tax decisions strongly opposed by business because of the impact on economic development. He suggests the revenue raising priority be extension of the sales tax to exempt consumer purchases like non prescription drugs, cable TV, hair care, and dry-cleaning. He rejects further broadening of the sales tax base: "I reject taxing business and professional services because of the fragility of the New York economy; it would be better if another state with a stronger economy, like Florida or California, were to become the first industrial state to have a broad service tax." As a temporary measure, in addition to the base-broadening, he suggests a sales tax rate increase combined with an income tax credit for low income persons to offset the regressivity of the sales tax.

In testimony before the U.S. House Ways and Means Committee (4/17), Gold suggested that many states have structural deficits. He predicted that "states will be increasing taxes in the 1990s," resulting in an increase in the percentage of personal income taken by state and local taxes and user charges. He characterized this prediction as "controversial." Even with the increases, he told the committee, which was inquiring into state solutions for national health care problems, that "the states cannot solve this problem by themselves."

While suggesting higher taxes, Gold is apparently willing to defend one-shot fiscal solutions. The Business Week article on one-shots (see lead article) closes its commentary with a comment from Gold: "It's normal and reasonable to use gimmicks in a temporary tight spot. It's just not good to use them year in and year out."

Bahl On State Tax Policy: While Gold moved from Colorado to New York, Roy Bahl moved from New York (Syracuse U.) to Georgia (Georgia State). Bahl has written extensively on state and local finances and has been involved in tax studies in many states. He published his prescriptions for Georgia in the Atlanta Constitution (4/14). He argues that the economy has changed from a time when consumers spent primarily for commodities, earnings were mostly wages and salaries, and real property was a greater proportion of individual wealth. The shift has left some portions of the economy undertaxed relative to the others.

He suggests that the tax system include services under the sales tax. He would minimize the difference in tax burdens on real property and intangible personal property (like stocks and bonds). For business income, he proposes eliminating the corporate income tax and reaching all business activity (whether corporate or not, whether profitable or not) with a value added tax. He would eliminate business tax incentives -- seeking lower rates for all businesses, not just for a few. The only tax breaks for the elderly would be means-tested, "While some of the elderly are truly disadvantaged and must be protected, the average retiree has an income that's higher than the average worker."

To start Georgia's reform, Bahl recommends a blue ribbon commission.

Tax Burdens: The Rhode Island Public Expenditure Council (300 Richmond St., Providence, RI 02903) compiles a handy pocket-sized set of tables ranking all 50 states called How Rhode Island Compares. It includes per capita and percent of personal income information for personal income taxes, sales taxes, and property taxes for FY 1989, reflecting data recently issued by the Census Bureau. Besides these standard items there are two different tables. One turns the personal income table upside down by reporting the percentage of personal income remaining after state and local taxes. This makes New Hampshire first rather than last and Alaska last rather than first.

The other unique table arrays taxes as a percentage of personal income for each year from FY 1985 through FY 1989, permitting easy consideration of changes. Nationally, there was essentially no change. State and local taxes were 11.58% of income in FY 1985 and 11.56% in FY 1989. {This percentage could rise sharply for FY 1991, reflecting slow income growth.} From FY 1985 to FY 1989, these are the more significant changes:

- Alaska and Wyoming reduced tax burdens, reflecting lower resource prices and thus tax revenues. Alaska stayed the highest tax state but Wyoming ceded second place to New York.
- Hawaii's burden increased from 12.8% of income to 14.6%, moving to fourth from ninth. Maine increased from 12.4% to 13.3%, moving from twelfth to sixth. Slight increases in New Mexico and Arizona moved them into the top ten, with ranks of eight and nine.
- Others in the latest top ten were Minnesota (fifth, formerly fourth), Wisconsin (seventh in both years), and Oregon (from thirteenth to tenth).
- In ranks from eleventh through 40th, the tax burdens differ little, from 12.3 to 10.7%. So there are many rank changes based upon small changes in tax burdens. The larger rank changes are Iowa (29th to 14th), Washington (22 to 15), Nebraska (41 to 19), Utah (8 to 22), West Virginia (14 to 25), Massachusetts (18 to 28), Pennsylvania (24 to 39), and Nevada (25 to 38).
- There was little change in the bottom ranks -- the states with the lowest tax burdens by this measure.

Statistical Compilations: Several compilations repackage information on finances, primarily data from federal reports like Government Finances in 1989.

The Tax Foundation's Facts And Figures On Government Finance: 1991 Edition (Johns Hopkins Press) is 359 pages of information on finances at all levels of government. The virtues of the publication are its length, and thus coverage, and the extensive use of historical tables. The weakness stems from the time it takes to produce a book of its length in hardback binding. The data stop with what was available in the Government Finances series for 1988. Anyone needing the latest data would have to supplement the volume with another source.

The Advisory Commission on Intergovernmental Relations (1111 20th St., N.W., Washington, DC 20575) Significant Features Of Fiscal Federalism deals with the problem of current data by splitting into two volumes. Volume 1, which has already been issued for 1991, is primarily a description of federal, state, and local tax systems (e.g., rates, base) in 1990. Its 174 pages of this information make it an excellent source for most such comparisons. Volume 2 will cover financial statistics like tax burdens and spending comparisons. It will appear later this year.

The new States In Profile should be arriving in subscribers' offices soon after they get this issue of **Reports**. *{Subscribers who have opted for a subscription without the twice-yearly Profile and full service subscribers who want to buy extra copies should call the subscription office.}*

Is State Spending Meeting "Need"? ACIR has also issued its long (115-page) version of Representative Expenditures: Addressing The Neglected Dimension Of Fiscal Capacity. The concept is to compare spending needs of the states by setting as a benchmark the average spending of all states relative to workload (e.g., spending per student). This gives a higher need measure to states with high workload measures, such as large numbers of pupils in relation to population. ACIR's calculations of need, using FY 1987 data, have been available for several years. They tend to show the least need in states with low percentages of population in poverty and few students (e.g., Connecticut) and the most in states with the reverse (e.g., Mississippi). States with high need would, other things being equal, have to spend more per capita than low need states to provide equal public services.

The new material in the report includes: (1) the detailed documentation of how the estimates were derived, (2) complex calculations which purport to permit adjustment of spending estimates for cost differences among states, and (3) extensive tables relating measures of need to actual spending levels and to measures of tax-raising ability using several criteria for tax capacity of the states. The impact of federal grants on capacity is also estimated. However, in providing all this methodological sophistication, ACIR didn't update the underlying numbers, which are for FY 1987.

Comparing States In Meeting "Need": The demographic and economic characteristics of states change slowly enough so that ACIR's basic conclusions remain appropriate for comparing states showing major differences. Table 7 shows the key information for selected states. The first column is the per capita "gap" between what a state would raise with average state and local tax policy and what it would spend with average state and local spending patterns. Nationally, there is no gap because the average taxes finance the average spending. For example, Mississippi could match the national average tax system and come up $1,298 per capita short of matching national spending averages. To maintain balanced budgets, some combination of below average spending and above average tax rates would be necessary. Conversely, Connecticut could match national average spending and taxes and have $1,274 left over for lower taxes and/or higher spending. These amounts can be expressed as percentages, which is done in the report. For example, the gap in Mississippi is 43% of the estimated spending while the advantage enjoyed by Connecticut is about 52%.

Table 7: Per Capita Gaps Between Spending Need And Revenue-Raising Capacity Of Selected States, FY 1987

State	Per Capita	Percent	State	Per Capita	Percent
Mississippi	$1,298	43%	**United States**	$0	0%
Alabama	900	31	Pennsylvania	49	2
Michigan	351	12	Florida	-322	-13
Texas	283	10	New York	342	13
North Carolina	244	9	California	-424	-16
Ohio	239	9	Massachusetts	-1,062	-45
Nebraska	152	6	Alaska	-1,269	-39
Illinois	137	5	Connecticut	-1,274	-52

Table 7 can be viewed as pricing a national equalization system equivalent to school finance equalization being undertaken in the states. The federal government could put all states on the same fiscal footing by taxing the amounts shown as minus numbers and distributing the proceeds in the amounts shown as plus numbers. With a less "Robin Hood" approach, it could simply make aid payments equal to the plus numbers. This plan would cost about $50 billion.

Budget And Tax Reform: In Florida, as elsewhere, there is continuing dissatisfaction with the state's budget process and the tax system. One response was voter approval of a 1988 constitutional amendment creating the Florida Taxation and Budget Reform Commission (251 Holland Bldg, P. O. Box 20869, Tallahassee, FL 32316) which recently issued its first report, A Program For Reform Of Florida Government. The group is a blue ribbon commission with members appointed by the governor and legislative leaders. Its 92-page report focuses on recommendations for budgeting rather than tax policy, though there are recommendations on local option taxes and tax administration.

The report addresses such subjects as the timing of legislative consideration of appropriations, the format of the appropriations bill, the extent of the line-item veto authority, rainy day funds, use of generally accepted accounting principles, agency authority to make transfers among appropriations, executive branch reorganization flexibility, and performance monitoring.

Intangibles Taxes: The use of taxes on intangible assets (e.g., stocks, bonds, copyrights) is addressed by an article by John Bowman and his Virginia Commonwealth U. colleagues in the National Tax Journal (12/90). The article reflects a 50-state survey of intangibles tax policies. The typical pattern is to consider income from such items as a basis of income tax liability, but not have a separate tax, a trend accentuated in the 1980s. Separate intangibles taxes now raise about $1.5 billion for state and local governments. Most of this is in states with no personal income tax -- Connecticut, Florida, New Hampshire, and Tennessee. Other significant users of what they call a "flawed tax" are Georgia, Kentucky, Louisiana, Michigan, North Carolina, Pennsylvania, and West Virginia. They list arguments against the separate intangibles tax, suggest states look elsewhere for revenue, and conclude, "The decline in the role of intangibles taxation has not been without reason."

MISCELLANY

Intergovernmental Relations Commissions: The U.S. Advisory Commission on Intergovernmental Relations is comprised of representatives of state, local, and federal governments. Its mission is making the federal system work better. In the 1970s, it recommended each state establish comparable entities. By its most recent inventory, State-Local Relations Organizations: The ACIR Counterparts, it counts 26 states with such organizations. Six are different organizational models, legislative commissions and local panels advising the governor. The budgets of the 26 vary from zero to over $1 million. Permanent staffs vary from none to 19. The publication provides details on the organizations in each state and an assessment of their impacts.

Desegregation Litigation: The Supreme Court's Brown v. Board of Education case eliminating segregation in public schools is now 37 years old. While nearly two generations of students have now gone through school systems that were not segregated (in the sense of not admitting blacks to white schools or whites to black schools), litigation continues at the elementary and secondary and university level. Some of it has major cost implications for some states.

The higher education case arises in Mississippi, but affects states that at one time maintained separate colleges and universities. Mississippi long ago stopped discriminating in the usual sense. As the U.S. Fifth Circuit Court of Appeals put it last year in a 9-4 decision, the state "satisfies its constitutional obligation by discontinuing prior discriminatory practices and adopting and implementing good-faith, race-neutral policies and procedures." The issue arises because some of the traditionally black schools are inferior to some of the traditionally white schools. The state's argument is that basically this doesn't matter so long as blacks are free to attend the traditionally white schools and do so in substantial numbers and whites attend the traditionally black schools. The alternative view is that, parallel to the situation in elementary and secondary education, the state must make additional investments in the traditionally black schools. The U.S. Supreme Court recently decided to take the companion cases (U.S. v. Mabus and Ayers v. Mabus) with argument likely this fall.

Pension Plan Investments: Adventurous investment policies by some state pension plans have been in the news lately. Most states limit the audacity, and thus riskiness, of pension fund management by prudence rules similar to those the states impose upon other trustees (e.g. charity boards, trustees of estates). Some states apply these rules to most pension fund investments but use a "basket clause" that authorizes retirement system administrators to invest a small percentage of fund assets outside those limitations. Often this authority isn't used, or is used to make investments that are conservative, such as mortgage-backed securities. But the riskier the investment, the higher the rate of return tends to be from a long-term perspective. So some retirement systems are making more aggressive investments with a part of their portfolios.

One is the Kansas Public Employees Retirement System which has been buying securities through private placements and investing in local enterprises. The result has been an estimated $118 million in losses, including a $65 million loss in Home Savings Association, a failed S&L. With 12% of its funds in real estate, the fund is also at risk from investments like shopping malls in Kansas, an industrial park in Dallas, and an office park in Phoenix. The fund trustees have placed a moratorium on similar investments. Several investigations are underway. In a move she said was to restore confidence in the board, the governor appointed herself as a trustee, an appointment that is subject to Senate confirmation. There is no allegation of criminal conduct, but the losses are triggering a reassessment of how elected officials monitor administration of the plan.

The Virginia Retirement System made national financial news (Wall Street Journal, 4/26) by a decision to risk up to 5% of its assets in commodities futures trading. The system also engages in short sales (selling something it doesn't own).

Population Counts: The Census Bureau's 1990 population counts drive allocation of Congressional and legislative seats, allocation of federal and state grants, and many comparisons (e.g., per capita taxes) that affect policy. But the counts are imperfect, with the issue being whether the imperfections can be quantified accurately enough to make adjustments. In late April, the Bureau released alternative estimates.

For the nation, the count produced 248.7 million people. By going back and checking selected areas (post-enumeration surveys), Census researchers concluded the right number is between 253 and 255 million. By a separate demographic analysis using birth, death and other information, researchers concluded the right answer lies between 252.8 million and 257 million. The next move will be a Census decision by July 15 on what count to certify. The Census Bureau could conclude, as it did after the 1980 Census, that adjusted figures would be more inaccurate than the original ones.

Potential adjustments wouldn't have equal impacts. The largest upward revisions are likely to be in central cities. From the post-enumeration methodology, even with the low end of the estimated ranges, no state count would be reduced by more than 2% with the largest adjustments in Pennsylvania, Kentucky, and the New England states. Using the top end of the range, there could be upward adjustments of over 4% in Arizona, California, Delaware, Florida, Georgia, Maryland, New Mexico, North Carolina, South Carolina, Virginia, and West Virginia.

TECHNICAL NOTES

Health Coverage; The data on uninsured persons and Medicaid coverage are from the Employee Benefits Research Institute (2121 K St., NW, Washington, DC 20037), Uninsured In The United States. The results are based on the March 199[illegible] Current Population Survey, which means they report what coverage persons interviewed thought they had. The survey sample was too small for estimates to be made for some of the smallest states Estimates for many less populous states are subject to some sampling error. Because of these factors, the Medicaid coverage reported on Table 4 may not be identical to that reported from other sources. Only the nonelderly are included because persons over 65 have Medicare coverage. A good summary of the characteristics of the uninsured is combined with an assessment of the prospects for controlling health costs in Rising Health Care Costs: Causes, Implications, And Strategies (Congressional Budget Office, 1991)

Tuition Setting: The study is Tuition Formulas At Work: An Examination of States That Use A Numerical Formula To Help Set College Tuition (Lawrence Gold for American Association of State Colleges and Universities). The tuition data come from the College Board (Box 886, New York, New York 10101) The College Cost Book, 1991. The data do not include adjustments made in the second semester by some institutions subjected to mid-year budget cutting by state governments.

State And Local Finance: The representative expenditure data presented in Table 7 use the representative tax system measure of fiscal capacity not taking into account federal aid. It uses the representative expenditure system definition of need, adjusting for price level differences.

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IN THIS ISSUE

The federal government accounts for nearly a quarter of the nation's economic activity. Where it spends this money makes a big difference for states, creating major winners and losers. Hustling federal grants isn't as important as it used to be. Nor, with cutbacks underway, is defense spending. But Social Security and Medicare are growing in impacts on state economies. The unending issue is whether federal funding is distributed equitably.

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- Federal Grant Programs p. 4
- Federal Jobs And Purchasing p. 4
- Federal Payments For Individuals p. 5
- "Fairness" Of Federal Impacts p. 7

Growing public school enrollments haven't been a major source of fiscal pressures on states. This is likely to change somewhat in the 1990s, but eleven states are predicted to have fewer pupils in 2000 than in 1990.

- School Enrollment Growth p. 10

State finances are looking worse. Revenues are falling below expectations. The many barriers to cost-cutting are being discovered. A record year for tax increases appears increasingly likely.

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- Barriers To Cost Cutting p. 15
- Tax Increases p. 18

Miscellany deals with reliance on exports, gambling, kids, rationing Medicaid services, university costs, and more. Technical notes indicate data sources and provide a summary table on federal spending by state.

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- Technical Notes p. 23

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May 1991 (Second of Two May Issues)

FEDERAL IMPACTS ON STATE ECONOMIES

Introduction: The federal government's impact on state economies is massive by just about any measure. Federal taxes and spending account for 20-25% of gross national product, with the exact amount dependent on the budget concept and year used for measurement. Over the 1980s, federal grants to state and local governments declined in relative significance, while federal payments of Social Security and Medicare increased substantially in real terms.

Considerable state effort is devoted to influencing the location of federal economic impacts. States compete to encourage the location of some facilities, like new research installations, and attempt to maximize federal grant allocations. With the recession killing off all but a few major new private installation construction decisions, federal decisions can seem like virtually the only game in town for economic development.

Overall Federal Impacts: The federal spending decisions affecting states reflect purchasing power of about $4,000 per capita nationally. The impact of these decisions differs considerably among states as shown in Table 1.

The range of deviations from the national average runs from Virginia with $1,900 more federal spending per capita to North Carolina with $931 less. This means that North Carolina lost out on $6.2 billion of purchasing power it could have had by being at the national average. This represents on the order of 200,000 jobs if each $30,000 represents about one job. Conversely, Virginia got about $11.8 billion of "extra" federal spending, or nearly 400,000 jobs.

Ten states had federal impacts 10% or more above the national average. Fifteen states were 10% or more below the national average. There isn't much consistent regional variation in federal impacts. The Southeast has the top state (Virginia) and the bottom one (North Carolina). New England has two states (Connecticut and Massachusetts) in the top ten, but two (New Hampshire and Vermont) in the bottom ten. Western states do better than average, but there are exceptions like Nevada and Oregon. Midwestern states are consistently poor performers in attracting federal dollars.

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Table 1: Per Capita Federal Impacts, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Virginia	$5,874	18	Maine	$4,011	34	Iowa	$3,587
2	Alaska	5,867		**United States**	**3,974**	35	Louisiana	3,582
3	New Mexico	5,703	19	Florida	3,970	36	Arkansas	3,509
4	Maryland	5,671	20	South Carolina	3,919	37	Ohio	3,496
5	Massachusetts	4,949	21	New York	3,918	38	Oregon	3,457
6	Hawaii	4,927	22	Mississippi	3,912	39	Nevada	3,448
7	Missouri	4,741	23	California	3,891	40	Minnesota	3,445
8	North Dakota	4,555	24	Idaho	3,862	41	Texas	3,428
9	Connecticut	4,484	25	Nebraska	3,860	42	Georgia	3,265
10	Colorado	4,428	26	Kansas	3,850	43	Delaware	3,226
11	Rhode Island	4,303	27	Pennsylvania	3,823	44	Illinois	3,210
12	Alabama	4,272	28	Utah	3,779	45	New Hampshire	3,209
13	Montana	4,186	29	Oklahoma	3,753	46	Vermont	3,148
14	Washington	4,140	30	Tennessee	3,701	47	Michigan	3,142
15	South Dakota	4,114	31	West Virginia	3,685	48	Wisconsin	3,052
16	Arizona	4,112	32	Kentucky	3,670	49	Indiana	3,051
17	Wyoming	4,089	33	New Jersey	3,664	50	North Carolina	3,043

Summarizing Federal Impacts: The total federal spending on which this article is based was just over a trillion dollars in FY 1990. The total excludes amounts spent abroad, interest payments on the federal debt, and certain other categories of spending where allocation among states was not practicable or meaningful. Most of the federal impact on state economies comes through direct federal activities, not grants to state and local governments, as shown in Table 2.

Table 2: Distribution Of Federal Funds, FY 1990

Category	Amount (billions)	Percent
Direct Payments For Individuals	$498	49.6%
Procurement	188	18.8
Salaries And Wages	146	14.6
Grants To State And Local Government	134	13.4
Other	36	3.6
Total	$1,003	100.0%

The following text and tables analyze how individual states are doing in these major components of federal financial impact. The same information is summarized for each state in the Technical Notes.

FEDERAL GRANT PROGRAMS

Per capita federal grants are most significantly influenced by the AFDC (welfare) and Medicaid programs. Broad eligibility criteria, high welfare grant levels, and high reimbursement rates for providers all tend to make these programs expensive, and thus make the federal as well as state share high in per capita terms. This explains the high rankings of states like New York, Rhode Island, and Massachusetts in Table 3.

Table 3: Per Capita Federal Grants To State and Local Government, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$1,303	18	Tennessee	$557	34	Utah	$487
2	Wyoming	1,253	19	Kentucky	555	35	Georgia	484
3	New York	876	20	South Carolina	542	36	Delaware	470
4	Rhode Island	770	21	Minnesota	541	37	California	468
5	Montana	740	22	Hawaii	540	38	Iowa	464
6	North Dakota	737		**United States**	533	39	Illinois	462
7	South Dakota	734	23	Arkansas	532	40	North Carolina	444
8	Vermont	670	24	Washington	528	41	Arizona	442
9	Massachusetts	641	25	Alabama	520	42	Indiana	437
10	New Mexico	633	26	Wisconsin	519	43	Colorado	434
11	Louisiana	630	27	Pennsylvania	515	44	Missouri	425
12	Maine	621	28	New Jersey	514	45	Kansas	412
13	Mississippi	620	29	Michigan	511	46	Texas	406
14	Oregon	601	30	Oklahoma	498	47	New Hampshire	385
15	Connecticut	600	31	Ohio	497	48	Nevada	368
16	Idaho	565	32	Nebraska	494	49	Virginia	361
17	West Virginia	562	33	Maryland	491	50	Florida	354

Sparsely populated Western states rank high in per capita aid for several reasons. First, like all small states, they benefit from minimum grants in some programs. Second, they receive funds as shared revenue from uses of the public lands like mineral leasing, grazing, and timber operations. Third, they benefit from programs oriented toward Native Americans. The recipe for being on the bottom of Table 3 is to have none of these characteristics and have relatively austere welfare and Medicaid programs.

FEDERAL JOBS AND PURCHASING

Wages And Salaries: Some federal salaries, such as those of postal workers, are fairly evenly distributed throughout the country. Others are concentrated at federal installations, particularly military bases. The resulting distribution is shown in Table 4.

Table 4: Per Capita Federal Wage And Salary Payments, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$2,249	18	Nebraska	$603	34	Louisiana	$442
2	Hawaii	1,954	19	California	596	35	Massachusetts	440
3	Virginia	1,665	20	Kansas	591	36	New Jersey	439
4	Maryland	1,276		**United States**	**579**	37	Pennsylvania	433
5	New Mexico	897	21	Delaware	576	38	Oregon	417
6	Colorado	837	22	Arizona	558	39	Illinois	416
7	Utah	828	23	Missouri	558	40	Arkansas	396
8	North Dakota	800	24	Rhode Island	556	41	Connecticut	385
9	Washington	736	25	North Carolina	538	42	Vermont	373
10	Oklahoma	725	26	Nevada	537	43	Ohio	362
11	South Dakota	722	27	Texas	533	44	New York	357
12	Wyoming	694	28	Kentucky	521	45	West Virginia	335
13	South Carolina	690	29	Florida	510	46	Indiana	325
14	Georgia	683	30	Idaho	505	47	Minnesota	308
15	Alabama	682	31	Mississippi	500	48	Iowa	264
16	Montana	654	32	Maine	457	49	Michigan	262
17	New Hampshire	624	33	Tennessee	456	50	Wisconsin	245

A high concentration of workers associated with public lands and military installations makes Alaska first, followed by Hawaii because of military bases, and the two states (Maryland and Virginia) bordering Washington, DC. States at the bottom of the list have few or no significant military installations or major civilian facilities like research laboratories.

Procurement: Procurement spending, which is primarily military, is shown in Table 5 (next page). The range of federal impacts is very wide -- from over $2,100 in New Mexico to a low of under $200 per capita in five states.

New Mexico leads the list because of procurement activities associated with atomic energy and nuclear weapons. Government contractors around Washington, DC and other military and civilian contractors account for Maryland and Virginia rankings. Massachusetts (Raytheon), Missouri (McDonnell Douglas), and Connecticut (United Technologies) have well-known large military contractors as well as many smaller ones.

FEDERAL PAYMENTS FOR INDIVIDUALS

Direct Payments For Individuals: In FY 1990, the federal government spent almost $1,000 per capita in Social Security payments and nearly $450 per capita in Medicare benefits. This enormous and growing purchasing power is distributed among the states by decisions of the retirees on where to live.

Table 5: Per Capita Federal Procurement Spending, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	New Mexico	$2,149	17	Nevada	$690	34	Georgia	$344
2	Virginia	1,643	18	Tennessee	678	35	Wyoming	322
3	Massachusetts	1,464	19	Texas	660	36	Oklahoma	278
4	Maryland	1,400	20	Mississippi	628	37	Nebraska	270
5	Missouri	1,360	21	Rhode Island	598	38	Wisconsin	258
6	Connecticut	1,352	22	Louisiana	565	39	North Dakota	256
7	Colorado	1,227	23	New Jersey	557	40	Iowa	252
8	Arizona	1,001	24	Ohio	557	41	North Carolina	240
9	California	991	25	Kentucky	545	42	Oregon	228
10	Alaska	962	26	Florida	511	43	Illinois	228
11	Utah	896	27	Hawaii	494	44	Montana	209
12	Idaho	856	28	New York	479	45	Delaware	208
13	Alabama	839	29	Minnesota	475	46	Vermont	190
14	Washington	810	30	Kansas	457	47	Michigan	183
15	Maine	767	31	New Hampshire	388	48	West Virginia	181
16	South Carolina	764	32	Indiana	356	49	South Dakota	171
	United States	**747**	33	Pennsylvania	350	50	Arkansas	166

Social Security, Medicare, and the retirement benefits of former federal workers constitute the bulk of the money covered in Table 6. The amounts also include such other direct payments as Food Stamps ($55 per capita) and Pell grants for college students ($17 per capita).

Table 6: Per Capita Federal Direct Payments, FY 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Florida	$2,541	18	Kansas	$2,043	34	Hawaii	$1,835
2	West Virginia	2,494	19	Mississippi	2,041	35	Vermont	1,821
3	Pennsylvania	2,425	20	Virginia	2,024	36	Louisiana	1,817
4	Rhode Island	2,283	21	Arizona	2,014	37	Nevada	1,811
5	Arkansas	2,249	22	Ohio	2,008	38	Indiana	1,808
6	Massachusetts	2,203	23	North Dakota	1,999	39	Idaho	1,790
7	Alabama	2,126	24	Nebraska	1,993	40	South Carolina	1,777
8	Michigan	2,116	25	South Dakota	1,990	41	North Carolina	1,741
9	Missouri	2,109	26	Illinois	1,985	42	New Hampshire	1,735
10	New Jersey	2,105		**United States**	**1,973**	43	California	1,729
11	Oregon	2,097	27	Kentucky	1,972	44	Colorado	1,726
12	Maine	2,090	28	Connecticut	1,967	45	Minnesota	1,724
13	New York	2,090	29	Tennessee	1,942	46	Texas	1,699
14	Oklahoma	2,076	30	Washington	1,917	47	Wyoming	1,698
15	Montana	2,057	31	Wisconsin	1,916	48	Georgia	1,673
16	Iowa	2,054	32	Delaware	1,905	49	Utah	1,446
17	Maryland	2,053	33	New Mexico	1,882	50	Alaska	1,113

Retirees tend to stay where they lived when they worked. This accounts for the high per capita numbers for states like Pennsylvania and West Virginia. Their population hasn't grown much overall, so retirees constitute a larger proportion of the population. States that have grown rapidly in recent years have fewer retirees in relation to population and rank low in Table 6. Also ranking high are retirement destination states like Florida and Arkansas.

"FAIRNESS" OF FEDERAL IMPACTS

Equity In Federal Impacts: The equity aspects of the distribution of federal purchasing power among the states are parallel to the equity aspects of distributing state funds among communities. There are three basic, and conflicting, logics involved:

(1) Returning money to the areas where it was raised.

(2) Distributing money in proportion to "need" as indicated by the logics of individual programs, such as putting education funds where students are and funds for defense purchases where the qualified contractors are.

(3) Distributing money pursuant to a development logic that concentrates operating funding in areas with least local fiscal capacity and infrastructure in areas that are the least developed economically.

While each of these philosophies is argued for federal policy, there is no overriding federal logic for fund distribution. Instead, decisions in each program are considered separately from the others. The data presented in this article show the results after the fact, not a considered policy before the fact. That is, there never was a federal decision for FY 1990 that Virginia should get more and North Carolina less. The individual decisions reflect all three logics, sometimes together. For example, highway funds are distributed largely on the basis of where the federal gas tax moneys are raised. Spending for Social Security, Indians, and disadvantaged children goes where those individuals are found. With the near demise of federal economic development programs, little money is distributed with a development rationale. However, the rationale motivates, to some degree, decisions on federal facilities expansions and closings. The distribution of some federal aid, like Food Stamps, follows a national standard of need. But the distribution of Medicaid tends to favor states with high fiscal capacity that can afford the matching requirements.

Where Federal Money Is Raised: The federal tax system is highly dependent on income-based taxes -- the federal personal income tax and Social Security payroll taxes. As a result, there is a close correlation between per capita federal taxes and per capita income.

The new estimates of per capita income for 1990 released by the Commerce Department appear in Table 7.

Table 7: Per Capita Personal Income, 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	$25,358		**United States**	**$18,685**	34	Arizona	$16,297
2	New Jersey	24,968	18	Pennsylvania	18,672	35	North Carolina	16,203
3	Massachusetts	22,642	19	Florida	18,586	36	South Dakota	15,872
4	New York	21,975	20	Michigan	18,346	37	Tennessee	15,798
5	Maryland	21,864	21	Kansas	17,986	38	Oklahoma	15,444
6	Alaska	21,761	22	Wisconsin	17,503	39	North Dakota	15,255
7	California	20,795	23	Missouri	17,497	40	Idaho	15,160
8	New Hampshire	20,789	24	Ohio	17,473	41	Montana	15,110
9	Illinois	20,303	25	Vermont	17,436	42	South Carolina	15,099
10	Hawaii	20,254	26	Iowa	17,249	43	Kentucky	14,929
11	Delaware	20,039	27	Nebraska	17,221	44	Alabama	14,826
12	Virginia	19,746	28	Maine	17,200	45	Louisiana	14,391
13	Nevada	19,416	29	Oregon	17,156	46	New Mexico	14,228
14	Washington	18,858	30	Georgia	16,944	47	Arkansas	14,218
15	Rhode Island	18,841	31	Indiana	16,864	48	Utah	14,083
16	Colorado	18,794	32	Texas	16,759	49	West Virginia	13,747
17	Minnesota	18,731	33	Wyoming	16,398	50	Mississippi	12,735

State rankings in per capita income tend to be relatively stable over time. One key to being near the top is to have high wage and salary rates to drive up the numerator of the calculation. Another key is to avoid having large numbers of children and retirees in relation to the working population, as they drive up the denominator. The patterns of personal income tend to be reflected in each state's share of federal taxes (States In Profile, Table F-13) and in per capita federal income tax liability (Profile, Table F-7). Per capita income taxes on CY 1988 income were $1,755 nationally. Connecticut was over $3,000 followed by New Jersey, Massachusetts, Nevada, and New Hampshire. Those states did not rank high in the per capita federal spending shown in Table 1.

Terms Of Trade: It is possible to relate any single element of federal spending in a state to the tax payments from that state to calculate "terms of trade." The implicit assumption is that 100% of tax payments that finance spending should be returned as spending in the state where the federal taxes were collected. This doesn't happen in federal grants to states for the same reasons it doesn't happen in state grants to local governments. Need, as defined by grant formulas, doesn't coincide with ability to pay as defined by the tax system. The terms of trade (Profile, Table F-2) are shown for illustrative states in Table 8.

Table 8: Terms of Trade With Washington
Selected States, FY 1990 ($ million)

State	Grants	Taxes	Difference	Return*
Mississippi	$1,595	$810	$785	197%
Alaska	717	382	335	188
New York	15,761	11,957	3,804	132
California	13,932	17,783	-3,851	78
Illinois	5,280	7,075	-1795	75
New Jersey	3,977	6,196	-2,219	64

* Percentage of taxes returned as grants.

Federal Spending And "Need": If federal spending were oriented toward indicators of comparative "need" in the states, vastly different federal distributions would occur. This would be true with just about any indicator of need. For example, the two top states in fiscal capacity, Alaska and Wyoming, would not be in that position in per capita federal grants.

There are many different ways to measure "need" and many different types of federal spending to consider. For the sake of illustration, Table 9 uses low per capita income (Table 7) as a need indicator and compares this need ranking with rankings in some of the other tables shown in this article. If federal policies were oriented to providing aid to states with the least fiscal capacity and/or lowest incomes, assistance would be concentrated on states with the top need ranks. The table suggests that this isn't the case.

Table 9: State Ranks in "Need" and Per Capita Federal Spending

Need Rank	State	Federal Spending Ranks			
		Total	Grants	Wages	Procurement
1	Mississippi	22	13	31	20
2	West Virginia	31	17	45	48
3	Utah	28	34	7	11
48	Massachusetts	5	9	35	3
49	New Jersey	33	28	36	23
50	Connecticut	9	15	41	6

The Outlook And State Strategies: State officials and Congressional delegations sometimes act as though they have a goal of maximizing federal spending in their states. This means, in effect, trying to improve the rankings on Table 1 by improving amounts that make up that total as shown on the other tables. To this end, they seek more favorable treatment for their states in grant formulas and discretionary grants and seek location of federal facilities of most types. Within states, there are efforts to help business, particularly small business, participate in federal procurement. Likewise, in some states there is increasing concern over where an affluent retired population goes. While attracting retirees is often the focus, a quantitatively important factor is how many retirees can be induced to stay in places like the Northeast and Midwest.

State officials have sought to keep federal installations by avoiding closings and to encourage continued purchases from their defense contractors. Competition is hot in many of these areas. In procurement, there are constant geographically oriented battles in the Congress. These involve whether certain weapons shall be purchased at all as well as the mix of weapons systems for particular applications, such as Navy fighter aircraft. Other battles involve the selection of contractors, such as the choice of a Connecticut versus Virginia location for procurement of a new Navy submarine. States and state Congressional delegations also are involved in issues over which bases should be closed and which should be expanded.

Besides trying to attract contracts, states try to attract contractors from other states. For example, in arguing that California isn't doing enough to keep aerospace jobs, two consultants recently (2/26) expressed concern in an OpEd in the Sacramento Bee about Missouri courting Lockheed, Georgia wooing Hughes, and Utah offering financial incentives to McDonnell Douglas. They note, "States like Oklahoma have offices in Los Angeles whose sole purpose is to raid our aerospace markets and take the business home."

During the 1990s, the rankings in Table 1 will change automatically and substantially as the distribution of federal spending changes. Current federal budget projections and other indications of the likely direction in federal policy suggest a dramatic change in the mix of federal policy. Direct payments to individuals will increase their share of the total with rising Social Security benefits (which escalate with inflation) and Medicare outlays (which rise automatically with health costs and consumption) for an increasing number of retired persons. This will help the rankings of Arizona, Florida, and other retirement destinations as well as Northeastern and Midwestern states. On current plans, the role of military procurement and pay will drop, adversely affecting the position of states with major military bases and defense contractors. Within grants, Medicaid will increasingly overshadow the other programs.

SCHOOL ENROLLMENT GROWTH

Structural Deficits: This year there is considerable discussion of "structural deficits" in state budgets. The concept of structural, as distinct from cyclical, deficits is fully articulated in California. There, budget information was presented this year in a way that clearly differentiates two portions of the deficit: (1) that built into spending and revenues in an economically typical year and (2) that related to revenue loss and spending increases associated with recession. In some other states, the distinction isn't necessarily calculated in detail, but is used by elected officials to signal an imbalance of revenues and spending built into the state's finances.

The hallmarks of structural deficits are major spending categories that inherently grow at a faster rate than revenues from existing taxes. This is plausible if a spending category is experiencing extraordinary price increases, as in health, or extraordinary growth in the population being served, as in corrections. In more routine functions, such as parks, current service budget concepts would suggest cost growth in line with an indicator like population growth plus a measure of inflation like the Consumer Price Index. Some state spending limits are calculated on that basis.

Education And Structural Deficits: Education accounts for over half of state general fund budgets. Therefore, the question of structural deficits hinges to a major degree on education cost pressures. Put another way, the ability of states to fund education quality measures with existing taxes depends in part on how fast the student population is increasing. Growth in the 1980s is shown on Table 10.

Table 10: Percentage Change In K-12 Enrollment, 1980-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Massachusetts	-18%	18	Maine	-4%	34	Louisiana	2%
2	West Virginia	-17	19	North Carolina	-4	35	Mississippi	4
3	Pennsylvania	-13	20	Missouri	-3	36	Kansas	4
4	Iowa	-13	21	Nebraska	-3	37	Colorado	5
5	Michigan	-13	22	Arkansas	-3	38	Idaho	5
6	New Jersey	-12	23	Montana	-3	39	Hawaii	5
7	New York	-10	24	Vermont	-2	40	New Hampshire	6
8	Connecticut	-10	25	Wyoming	-2	41	Georgia	7
9	Ohio	-10	26	Minnesota	-1	42	Washington	7
10	Indiana	-10	27	Oklahoma	-1	43	New Mexico	14
11	Illinois	-9		**United States**	0	44	Texas	14
12	Rhode Island	-8	28	Virginia	0	45	California	19
13	Kentucky	-7	29	Oregon	0	46	Arizona	20
14	Wisconsin	-6	30	Delaware	0	47	Florida	20
15	Alabama	-5	31	South Dakota	0	48	Nevada	26
16	Maryland	-5	32	South Carolina	0	49	Utah	28
17	Tennessee	-4	33	North Dakota	1	50	Alaska	29

During the 1980s, education costs weren't *inherently* a major factor in increasing state and local fiscal problems. In most states, they were a cost-increasing factor only because of state and local decisions that cut class sizes, provided early childhood education, and raised school employee compensation substantially faster than inflation. There was almost no change in the number of public school children nationwide from the fall of 1980 to the fall of 1990. Many states experienced significant decreases in enrollment as shown in Table 10.

During the decade, population grew by about 1% a year and the number of persons employed grew even faster. Less than a fifth of the states had this much growth in school enrollment. Having more rapid growth in taxpayers than in students helped states to finance substantial increases in real spending per pupil and in the percentage of school costs paid by states.

Enrollment Projections: Enrollment projections by the U.S. Department of Education suggest that the level enrollment of the 1980s won't persist into the 1990s. Table 11 shows the percentage of projected enrollment change over the 1990s and the number of pupils involved.

Table 11: Projected Change In K-12 Enrollment (000), 1990-2000

Rank	State	Percent	Pupils	Rank	State	Percent	Pupils
1	Arizona	29%	178	26	Alabama	6%	40
2	New Mexico	28	86	27	Mississippi	4	19
3	New Hampshire	25	45	28	Illinois	4	68
4	Alaska	24	27	29	Oklahoma	3	19
5	Florida	21	374	30	New York	3	84
6	Georgia	20	230	31	South Dakota	3	4
7	New Jersey	19	212	32	Washington	3	24
8	Maryland	17	122	33	Oregon	3	13
9	California	16	801	34	Michigan	2	30
10	Virginia	16	162	35	Kansas	2	8
11	Colorado	14	79	36	Arkansas	2	7
12	Delaware	13	13	37	Tennessee	1	11
13	Nevada	13	24	38	Wisconsin	1	4
14	Utah	12	55	39	Wyoming	0	0
15	North Carolina	12	128	40	Louisiana	-1	-7
16	Vermont	12	11	41	Pennsylvania	-1	-15
17	Massachusetts	11	91	42	Nebraska	-1	-3
18	Texas	11	360	43	Indiana	-1	-11
19	Hawaii	10	18	44	Ohio	-1	-22
20	Rhode Island	10	14	45	Idaho	-3	-6
21	Connecticut	9	44	46	Kentucky	-4	-24
	United States	**8**	**3396**	47	Montana	-5	-7
22	Maine	8	17	48	North Dakota	-7	-8
23	South Carolina	7	44	49	Iowa	-8	-37
24	Missouri	7	55	50	West Virginia	-10	-33
25	Minnesota	6	48				

Table 11 shows a nationwide increase in pupils of 8%, slightly below the rate of population growth. The growth is unevenly distributed. Eleven states are projected to have declining enrollment. Four have no change predicted. Half have 5% or smaller increases. Nearly half the projected growth of 3,396,000 pupils is concentrated in California (801,000), Florida (374,000), and Texas (360,000).

These three states are viewed by most local observers as having structural deficits over the long term. Elementary and secondary education is a major portion of the spending pressure in each. The California Proposition 98 guarantees to elementary and secondary education and the implied state aid commitment in Texas school equalization add to the spending commitment.

Higher Education: Projecting higher education enrollment is much more difficult than making elementary and secondary projections. The projections are much more sensitive to decisions affecting: (1) the percentage of high school graduates who attend college, (2) how long they stay in school, and (3) the extent to which those individuals beyond what used to be college age attend school. There is every reason to believe that these decisions are sensitive to tuition policies. If the tuition increasing tendencies of 1990 and 1991 persist, enrollment trends are likely to be significantly affected by price changes.

A key part of the underlying demographics of enrollment at public higher educational institutions is the number of students who graduate from high school in each state. Those trends for some representative states are shown in Table 12.

Table 12: Number of High School Graduates (000), Selected States

State	1991	2000	Percent Change
California	230.6	333.6	44.7%
Florida	86.9	125.0	43.8
Washington	45.4	62.1	36.8
Georgia	57.0	68.6	20.4
United States	**2,232.5**	**2,624.8**	**17.6**
Texas	170.2	198.1	16.4
Pennsylvania	104.0	116.8	12.3
New York	136.6	150.0	9.8
Massachusetts	48.1	52.7	9.6
Michigan	90.4	95.9	6.1
Illinois	103.4	108.6	5.0

The table suggests relatively mild growth in college enrollment from demographic factors. But during the 1980s, much of the increase in enrollment was driven by more persons going to college and staying there longer. The same pattern could be repeated in the 1990s. While the predicted growth in high school graduates is mild nationwide, some states will experience increased demand for places in state universities.

California is one of those states. There have been plans for new campuses, with the higher education coordinating board currently suggesting at least one major university and over 20 community college campuses. These plans are on hold. State fiscal officials have been discouraging new bond issues because of the impact on operating costs and the state credit rating. Responding to these arguments and a general sentiment to vote no on all ballot issues, voters rejected a $450 million higher education bond issue last November. Anticipating an austere FY 1992 budget even if taxes are increased, some campuses are reducing course offerings and limiting the number of students admitted.

REVENUE SHORTFALLS

Revenue Below Expectations: Many states are reporting serious shortfalls in March and April tax revenues. There are some well known reasons for this, but they tend to be forgotten because state memories of revenue performance in recessions date back to the early 1980s. It is reasonable to expect state revenue to respond -- more or less, depending on the state's economy and tax structure -- to changes in personal income. That is, personal income growth of 8% should be, and generally has been, associated with state revenue growth of about 8%. If personal income growth slows to 4%, revenue growth would be expected to slow to about 4% and revenues would be below an estimate based on prosperity-linked 8% growth. This was the expected part, with many state revenue estimates already scaled down to slower growth.

Revenues In Recession: The difficulty is that some aspects of the economy behave asymmetrically in recession, with deleterious effects on tax revenues. First, graduated personal income taxes mean that lower incomes put some taxpayers in lower tax brackets and mean they pay a lower percentage of their income in tax. Second, spells of unemployment in 1990 mean that many households were subject to overwithholding of state income taxes and are getting their money back by refund claims in the spring of 1991. Third, recession disproportionately reduces income subject to withholding, wages and salaries. Less affected are other components of income: (1) income like dividends and interest not subject to withholding and (2) income that is exempt or lightly taxed -- Social Security, welfare payments, and unemployment compensation. These are growing components of the personal income total in a recession.

Fourth, sales tax revenues suffer when consumers have declining borrowing power because they have lost their jobs or declining willingness to borrow because of uncertainty. This affects the purchasing of big ticket items subject to sales tax like autos, boats, furniture, and appliances. Consumers with declining income also don't cut back their spending proportionally. Mortgage payments, health care, credit card and car payments, and food -- all generally not subject to sales tax -- tend to continue. Finally, corporate profits taxes drop in recession because corporate profits drop in recession.

Examples Of Shortfalls: Massachusetts, with severe recession, reflects these factors. Net of tax increases, March collections were down 19.9% from last March. Even with the increases, they were down 4.4%. Collections of sales taxes for the fiscal year through March were down 4%. Regular sales taxes were off 1%, but vehicle sales taxes were down 22%. Corporate taxes were off 27%. Public utility taxes dropped 12%. Georgia's March results were 10.6% below last year's. Administrative savings measures are underway, though state officials still hope for the 3.2% revenue growth assumed in the budget.

BARRIERS TO COST CUTTING

Introduction: In December and January, many governors announced major cost-cutting measures to restore balance to current year budgets and bring FY 1992 spending and revenue in line without tax increases. The effects haven't always been as announced and new cost pressures have developed. This article provides a sampling of the cost pressures and problems, including the interplay of state and local finances.

Firing Teachers: This spring, there have been many reports of teachers, including those who have won prizes of various kinds, being fired. What's happening? In a few cases, the teachers won't be back this fall because (1) they were fired for non-financial reasons, like conduct, but this is rare or (2) their district can't afford them. In the bulk of the cases {**Reports** can't offer quantitative proof}, they are affected by the interaction of local contracts and state fiscal cycles.

Local contracts often give teachers contractual rights for the fall term unless they are notified otherwise in the spring. In the spring, school administrators have uncertainties about the number of teachers who won't be coming back (death, disability, retirement, changing jobs) and about state aid for the new fiscal year. It is not uncommon for them to assume the lowest conceivable attrition and state aid and issue notices accordingly. Teachers, who seem to understand the process much better than the media, then receive notice before the fall that they have been invited to return. Actual layoff of experienced teachers is rare.

The notice requirements sometimes become a tool for school boards, which fail to give notice on a timely basis. This situation developed in Boston in early May. The Boston School Committee rejected the recommendation of its superintendent and the urging of Boston's mayor and refused to notify 349 teachers. The Committee, which gets its financing from the city, wasn't buying the mayor's budget recommendation. The school move blocks layoffs as an option, forcing concentration on other types of cost-cutting measures.

In Indianapolis, the situation is nearly reversed with the school district making its decisions, including pay, premised on a state aid increase of 5%. As it becomes increasingly clear that the Indiana legislature won't provide the increase, the district has announced layoffs of about 600 employees.

Medicaid Costs: The state budget officers (NASBO News, May) have developed summary statistics and projections reflecting the pressures Medicaid costs are putting on state budgets, as shown in Table 13.

Table 13: Medicaid Costs Pressure State Budgets

	State Costs		Total State/Federal
Fiscal Year	Pct. Of Budget	$ billion	Cost ($ billion)
1980	9%	$11	$26
1985	10	18	41
1990	14	31	71
1995 est.	22	67	155

The compilation includes only cost factors associated with existing law, but no new Congressional mandates. However, many new and expensive Medicaid mandates are pending in the Congress.

Medicaid Drug Coverage: New York, and probably other states, is under pressure to adopt additional drugs and treatments in its Medicaid programs at the same time that they attempt to limit the cost of the program. The situation is widespread, affecting procedures (e.g., transplants) as well as drugs. Clozapine is a new drug to treat schizophrenia which costs about $4,000 per year per patient for the drug and $2,500-5,000 for the monitoring and testing associated with its use. In January, a public interest law group sued New York and won a preliminary decision that the state cannot use financial reasons to avoid providing "medically necessary services" under Medicaid. The manufacturer indicates some 40 states already provide coverage, which New York does for persons in its mental hospitals. At $7,000 a case for 10,000 cases, the tab would be $70 million with the federal government paying half and state and local government paying the other half.

Welfare Rules: The governor of Pennsylvania adopted a number of cost-cutting devices affecting welfare recipients which, under Pennsylvania law, are subject to procedures for the review of administrative regulations. By invocation of emergency procedures, three of the rules have gone into effect despite a 3-2 rejection by the Independent Regulatory Review Commission. The three involve raising the copayment on Medicaid prescriptions by 50 cents to $1, cutting off benefits from those convicted of welfare fraud, and limiting transportation expenses for those in job training programs. To continue those policies beyond four months, the administration needs approval from the welfare committees in both Houses of the legislature. A fourth rule, limiting the amount any single household can get from general assistance, was withdrawn in the face of expected opposition in the Commission.

Interactions Of Social Programs: Many cost-cutting proposals are confronted with the argument that cutting funds in one program will increase spending in another one. Some of these arguments are quite general, such as the contention that spending less on schools will cause prison populations to rise.

Others, such as those being made in Massachusetts, are much more specific. Opponents of cuts in general assistance contend they would result in increasing the number of homeless, placing more burdens on the state's extensive programs for them. But one major program for the homeless, state subsidies that are parallel to federal Section 8 rent subsidies (but don't have parallels in most states), are themselves getting the axe. The head of the Massachusetts Housing Finance Agency warns the state can't untangle easily. Many of the 18,000 families getting state supplements of nearly $1,000 a month are living in buildings financed by the Agency. It fears mortgage defaults without the subsidies.

In Maine, the argument against cutting areawide agencies for the aged programs (e.g., homemakers, meals on wheels) is that the result would be greater use of nursing home care. Critics of proposals to limit AFDC eligibility and reduce payment levels argue doing so would increase Maine's state and local general assistance costs.

New York City Problems: Mayor Dinkins drew an audience of an estimated 1.6 million people as major TV and radio stations gave him prime time on May 8 to talk about city finances. He announced "the time for games is over" and that the time to balance the budget had arrived. The mayor is trying to deal with a shortfall of $3.5 billion in an annual budget of $29 billion.

His solution includes about $1 billion in new taxes. These include real property tax increases that require approval of a reluctant council and other increases that require the approval of the state legislature. Major Dinkins has a long list of spending cuts including not operating some street lights, closing the Central Park zoo, cutting back drug rehabilitation programs, eliminating as many as 20,000 jobs, and seeking "givebacks" from public employee unions.

Litigation Over Personnel Actions: The austerity plan in Pennsylvania includes a 10% cutback in the pay of supervisory employees. The 3,000 workers went to court and obtained a temporary restraining order from a state court prohibiting the cut. The state is appealing. The same court had previously rejected the plan as applied to the independent Fish and Game operations. However, about 9,600 management-level employees have been subjected to the cut.

Legislative-Executive Disagreements: Legislative approval of cost cutting proposals by the governors isn't automatic. For example, the legislature in Michigan rejected the governor's proposal to prevent a scheduled 4% employee pay raise from going into effect. Similar disagreements are a major factor in cutback policy in Maine, Massachusetts, and Pennsylvania -- to mention only a few states affected.

TAX INCREASES

How Big Is The Tab? The combination of new revenue shortfalls and frustrations in achieving expected spending cuts auger for tax increases greater than the $6-7 billion requested in governors' budgets earlier this year. The perceived acceptability of increases has probably grown as a result of well-publicized barriers to implementing spending cuts and widespread publicity about deleterious effects of proposed cuts.

Post-Election Tax Hikes: Historically, 1991 may be a good year for tax increases in most states. It is widely believed that governors and legislators seeking reelection are prone to emphasize use of one-time revenues, to defer spending, to overestimate revenues, to underestimate spending, and to draw down balances during election years to avoid tax increases or sharp spending cuts. When elected, the theory goes, state elected officials often enact tax increases. It is true that a large number of governors and legislators elected in 1982 and in 1990 discovered serious fiscal problems in early 1983 and 1991 that they didn't see before the elections. The phenomenon wasn't as significant in 1986 and 1987, when the booming economy was swelling state revenues.

Elections And Tax Timing, Louisiana: The Public Affairs Research Council of Louisiana has quantified the results for that state's budget. The results appear in Table 14, for the first year of each governor's term and the final year (e.g., FY 1992 for the Roemer term than ends in early 1992 after elections in November of 1991). The data support the conclusion that Louisiana officials tended to run deficits in election years, but surpluses (e.g., by tax increases) after elections.

Table 14: Louisiana General Fund Surplus (Or Deficit)
Selected Years, FY 1973 To FY 1992 (est.), Millions Of Dollars

Governor	Election Held	First Year Result	Election Year
Edwards	1971	$23	-$68
Edwards	1975	37	166
Treen	1979	7	-146
Edwards	1983	65	-66
Roemer	1987	1,167	-386

Elections And Tax Timing, US: The same calculation can be made for states in the aggregate as shown in Table 15. Most states held statewide elections in 1990 and four year intervals before that, but the table lumps those states with others on different schedules.

Table 15: Percentage Increases In State Taxes

Year Of Election	Percent Increase In State Taxes	
	Year Of Election	Year After Election
1966	1.7%	7.8%
1970	1.7	9.7
1974	0.5	2.0
1978	-2.0	-1.6
1982	1.8	4.8
1986	0.5	1.9
1990	3.0	?.??
Average	1.0%	4.1%

The average increase in pre-election years was 1%. A substantial part of it was in the minority of states that don't hold statewide elections in the years shown. For example, New Jersey, which held statewide elections in 1989, didn't raise taxes in that year but contributed a major portion of the 1990 state tax increases. The math is only suggestive, but if the 1991 tax increases are 3% above those of 1990, reflecting the pattern shown on the table, then state taxes will be increased by over $17 billion in 1990. This would surpass (without inflation adjustment) the previous highs of increases between $8 billion and $9 billion last year and in 1983.

California's Tax Choice: California is the first major example of a governor who revised original budget recommendations to allow for higher taxes. Recognizing that the California budget gap has grown from under $7 billion to nearly $13 billion, Governor Wilson has recommended a new package of tax increases and spending cuts. His primary tax choice was the sales tax with (1) extensions of the tax base to snack foods, candy, aviation fuel, newspapers, and more and (2) an increase in the rate by 1.25%, which will bring the rate to about 8% in many California communities. A package previously submitted by legislative leaders relied heavily on increasing the top bracket rate of the income tax. In defending his choice, Wilson called the sales tax "the least threatening to the creation of the new jobs that our state must have to avoid greater unemployment and greater safety-net costs that would take California into an onward and ongoing downward spiral."

There are other examples. New York's budget compromise appears likely to include somewhat different and higher tax increases than those proposed by the governor. The governor of Texas has conceded that rejection of her lottery proposal and enactment of the school finance plan will, contrary to her original recommendation, require new taxes. A subtle tax increase, developed by ending a deduction in the income tax, appears to have a good chance of being included in the Illinois fiscal plan.

MISCELLANY

Export Reliance: As recession worries continue, one possible source of recovery for some state economies is exports. There is considerable interest in state economic development agencies in measuring exports on a state-by-state basis, but there are many data problems. A new Census Bureau report provides relatively antique data, but illustrates the importance of manufacturing exports. The data are shown in Table 16 (next page).

Gambling: Connecticut is facing a difficult problem of deciding how much gambling is too much. Legal gambling in the state includes jai alai, dog racing, the lottery, and off-track betting. No casino gambling has been authorized, but charitable organizations are allowed Las Vegas nights. This authorization, combined with the federal Indian Gambling Regulatory Act, allows the Pequot Tribe (under 300 people) to establish a $50 million casino -- at least as the Tribe sees the situation. Connecticut officials didn't agree, but have lost in lower court. In April, the U.S. Supreme Court refused to consider the case.

The tribe is building while the governor looks for a way to avoid casino gambling. The only way may be to eliminate Las Vegas nights, but the charities benefiting from them object. On the theory "if you can't beat them, join them," there is some sentiment for the state to legalize casino gambling off reservations.

Table 16: Percent of Private Sector Jobs Linked With Manufacturing Exports, 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	9.2%		**United States**	**6.3%**	33	Kentucky	5.4%
2	Washington	9.1	18	Idaho	6.2	35	Colorado	5.0
3	Vermont	8.9	18	New York	6.2	35	Georgia	5.0
4	New Hampshire	8.2	18	Pennsylvania	6.2	37	Florida	4.8
5	Massachusetts	7.9	21	Alabama	6.0	37	Utah	4.8
5	Michigan	7.9	21	New Jersey	6.0	39	Virginia	4.7
7	Ohio	7.8	23	Alaska	5.9	40	Oklahoma	4.6
8	Rhode Island	7.5	24	Tennessee	5.8	41	Nebraska	4.5
8	South Carolina	7.5	24	West Virginia	5.8	42	South Dakota	4.4
10	Indiana	7.4	26	Arkansas	5.7	43	Louisiana	4.3
11	Wisconsin	7.3	26	Iowa	5.7	44	Maryland	4.0
12	California	7.2	26	Maine	5.7	45	North Dakota	3.7
13	Minnesota	7.1	26	Missouri	5.7	46	Montana	3.2
13	Oregon	7.1	36	Texas	5.7	47	New Mexico	2.9
15	North Carolina	6.5	31	Kansas	5.6	47	Wyoming	2.9
16	Arizona	6.4	32	Mississippi	5.5	49	Nevada	2.4
17	Illinois	6.3	33	Delaware	5.4	50	Hawaii	1.9

Kids Count: A new report (see Technical Notes) uses some standard indicators, like infant mortality rates, to define how well children are doing in each of the states. Nationally, the report suggests improvements in some indicators (e.g., young child death rates), but little progress in others (e.g., low birth weights). The rankings of the states tend to correlate with per capita income. The top ranked states for 1991 were: (1) Vermont, (2) Utah, (3) Minnesota, (4) New Hampshire, (5) Connecticut, and (6) Rhode Island. Poorest conditions were found in (46) New Mexico, (47) Mississippi, (48) South Carolina, (49) Louisiana, and (50) Georgia.

Medicaid Service Rationing: Oregon's plan to rationalize decisions on what services to cover under Medicaid received extensive publicity well in advance of implementation. The detailed plan still hasn't received either legislative approval or the federal waiver required to begin operation.

The issues that the plan explicitly raises are those faced in all states where they typically aren't raised. For example, if there is money to do only one, is it better to do one expensive transplant for a 70-year old or to provide preventive services for 400 youth? Rather than express an opinion, it is easier to be for providing enough money to do both. For an excellent discussion of the priorities issue, using Oregon as an example, see the article by David Hadorn (RAND Corp.) in the Journal of the American Medical Association (5/1) and comments by Normam Daniels (Tufts U.).

University Costs: The usefulness (and arguably mischief) of interstate comparisons of aspects of state spending is suggested by university comparisons developed by New York's Comptroller (State Office Building, Albany, NY 12236). The 40-page report on the state's university system (Staff Study Comparing SUNY Finances With Similar State Universities) uses data on peer institutions in other states to establish that certain costs are *prima facia* too high in New York. The university system has complaints about the numbers and some numbers of its own, which adds another 33 pages. **Reports** is not in a position to affirm or criticize the numbers, but offers some key ones in Table 17. {For detailed definitions, see Technical Notes.}

Table 17: Costs (000) Per Full-Time Student, Selected States, FY 1989

State	Large Univ.	Four Year A	Four Year B	Two Year
Ohio	$7.7	$6.7	$5.3	$4.2
Indiana	9.9	4.9	5.3	6.1
Illinois	10.5	7.1	n.a	3.5
Michigan	10.7	6.3	5.7	5.3
Iowa	11.1	6.7	n.a	6.1
New York	11.7	6.6	8.0	6.4
Washington	12.1	6.4	8.2	3.6
Texas	12.5	4.1	7.2	6.3
Florida	13.6	8.5	n.a.	n.a.
North Carolina	17.2	n.a.	n.a	4.7
Median For Category	11.1	6.4	6.4	4.6

The report also presents a comparison of university teaching hospitals which show that most just about break even, with revenues within 6% of spending. The exception on the high side was Wisconsin's which earned 6.5% on sales. On the low side was New York, where three medical schools combined lost $80 million, or 20% of revenues, in FY 1989. The big loser was the University of Texas which lost $115 million, more than its revenues. The big difference probably reflects: (1) how generous each state's Medicaid program is and (2) how aggressively the teaching hospital seeks to qualify patients for Medicaid. The Texas comptroller has been issuing reports claiming the state loses hundreds of millions each year by not taking advantage of Medicaid.

Items: Pat Uunnicke assesses the think tanks that deal with state policy issues in State Legislatures (March). Will hard pressed states and cities sell so many assets to the private sector that securities firms can develop a new line of business around their decisions? This question is asked in an article in the Wall Street Journal (5/9) which reports that some firms are establishing new units to handle the business.

TECHNICAL NOTES

Federal Funds: The statistics are from the Commerce Department's Federal Expenditures By State For Fiscal Year 1990. There are counterpart reports for political subdivisions of states in the two volumes of Consolidated Federal Funds Report, Fiscal Year 1990. The per capita statistics (excluding a small quantity of "other") are grouped below by state for reader convenience in assessing where a particular state stands in total and why. The calculations distributing federal tax burdens by state are developed by the Tax Foundation (470 L'Enfant Plaza, SW, Washington, DC 20024). The Foundation popularizes them in "tax freedom day" calculations, most recently appearing in its Special Report (April).

Education Costs: The projections are from the U.S. Department of Education, Projections Of Education Statistics To 2001: An Update.

Post-Election Tax Increases: Table 15 relies on data from NCSL's annual State Budget And Tax Actions and, for earlier years, information compiled by Steven Gold (State University of New York at Albany).

Manufacturing Exports: The Census Bureau report is Exports From Manufacturing Establishments.

Kids Count: The Kids Count Data Book is the product of The Center For The Study Of Social Policy, 1250 Eye St., NW, Washington, DC 20005. The indicators presented for each state are two indicators of infant health (low birth weight, infant mortality), two of children's deaths (total and teen violent deaths), out-of-wedlock births to teenagers, high school graduation rate, poverty rate, and juvenile incarceration rate. The National Conference of State Legislatures 91560 Broadway, Denver, CO 80202) has enough special publications on state policies toward children to merit a special little catalogue of them.

University Costs: The comptroller defines categories in detail in the report. In summary, large universities have a medical school but not hospital, the first category of four year institutions offers masters degrees and a few doctorates, the second category doesn't offer doctorates.

Table A-1: Per Capita Federal Impacts, FY 1990 With Ranks

State	Total		Grants		Salaries		Payments		Procurement	
	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount
Virginia	1	$5,874	49	$361	3	$1,665	20	$2,024	2	$1,643
Alaska	2	5,867	1	1,303	1	2,249	50	1,113	10	962
New Mexico	3	5,703	10	633	5	897	33	1,882	1	2,149
Maryland	4	5,671	33	491	4	1,276	17	2,053	4	1,400
Massachusetts	5	4,949	9	641	35	440	6	2,203	3	1,464
Hawaii	6	4,927	22	540	2	1,954	34	1,835	27	494
Missouri	7	4,741	44	425	23	558	9	2,109	5	1,360
North Dakota	8	4,555	6	737	8	800	23	1,999	39	256
Connecticut	9	4,484	15	600	41	385	28	1,967	6	1,352
Colorado	10	4,428	43	434	6	837	44	1,726	7	1,227
Rhode Island	11	4,303	4	770	24	556	4	2,283	21	598
Alabama	12	4,272	25	520	15	682	7	2,126	13	839
Montana	13	4,186	5	740	16	654	15	2,057	44	209
Washington	14	4,140	24	528	9	736	30	1,917	14	810
South Dakota	15	4,114	7	734	11	722	25	1,990	49	171
Arizona	16	4,112	41	442	22	558	21	2,014	8	1,001
Wyoming	17	4,089	2	1,253	12	694	47	1,698	35	322
Maine	18	4,011	12	621	32	457	12	2,090	15	767
Florida	19	3,970	50	354	29	510	1	2,541	26	511
South Carolina	20	3,919	20	542	13	690	40	1,777	16	764
New York	21	3,918	3	876	44	357	13	2,090	28	479
Mississippi	22	3,912	13	620	31	500	19	2,041	20	628
California	23	3,891	37	468	19	596	43	1,729	9	991
Idaho	24	3,862	16	565	30	505	39	1,790	12	856
Nebraska	25	3,860	32	494	18	603	24	1,993	37	270
Kansas	26	3,850	45	412	20	591	18	2,043	30	457
Pennsylvania	27	3,823	27	515	37	433	3	2,425	33	350
Utah	28	3,779	34	487	7	828	49	1,446	11	896
Oklahoma	29	3,753	30	498	10	725	14	2,076	36	278
Tennessee	30	3,701	18	557	33	456	29	1,942	18	678
West Virginia	31	3,685	17	562	45	335	2	2,494	48	181
Kentucky	32	3,670	19	555	28	521	27	1,972	25	545
New Jersey	33	3,664	28	514	36	439	10	2,105	23	557
Iowa	34	3,587	38	464	48	264	16	2,054	40	252
Louisiana	35	3,582	11	630	34	442	36	1,817	22	565
Arkansas	36	3,509	23	532	40	396	5	2,249	50	166
Ohio	37	3,496	31	497	43	362	22	2,008	24	557
Oregon	38	3,457	14	601	38	417	11	2,097	42	228
Nevada	39	3,448	48	368	26	537	37	1,811	17	690
Minnesota	40	3,445	21	541	47	308	45	1,724	29	475
Texas	41	3,428	46	406	27	533	46	1,699	19	660
Georgia	42	3,265	35	484	14	683	48	1,673	34	344
Delaware	43	3,226	36	470	21	576	32	1,905	45	208
Illinois	44	3,210	39	462	39	416	26	1,985	43	228
New Hampshire	45	3,209	47	385	17	624	42	1,735	31	388
Vermont	46	3,148	8	670	42	373	35	1,821	46	190
Michigan	47	3,142	29	511	49	262	8	2,116	47	183
Wisconsin	48	3,052	26	519	50	245	31	1,916	38	258
Indiana	49	3,051	42	437	46	325	38	1,808	32	356
North Carolina	50	3,043	40	444	25	538	41	1,741	41	240
United States		**3,974**		**533**		**579**		**1,973**		**747**

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VOLUME 9 ISSUE 11

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Legislators are debating the merits and mechanics of concentrating state tax increases on the rich. A new report suggests most states concentrate burdens on the poor. State decisions on tax increases this year reflect no consensus on what is best.

o Taxing Rich And Poor p. 10

Health care financing remains an intractable problem for state and federal officials. Disputes between the two are coming on medical malpractice rules and Medicaid "bootstrap financing."

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State and local costs for employee benefits are a substantial part of the compensation package -- much more substantial in some states than others.

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June 1991 (First of Two June Issues)

STATE BUDGET DEVELOPMENTS

The Search For Solutions: Officials of the largest states are continuing their struggle to find acceptable ways to enact balanced budgets. Of the ten largest states, with 55% of the nation's population, nine hadn't reached agreements on the broad outline of budget policy by the end of May. That is, there wasn't agreement on how much of the budget problem would be handled by spending cuts and how much by tax increases. Nor was there agreement on what spending cuts or what tax increases would be used. The exception was Florida, where the agreements include one to address "tax reform" (the euphemism for tax changes, including a possible income tax or major broadening of the sales tax) next year.

Public Opinion on Shortfalls: A Michigan public opinion poll suggests the difficulties elected officials face in dealing with state fiscal problems. Only 9% of those interviewed would increase taxes enough to avoid any reduction in state services, leaving 91% looking for some action to cut spending.

Most of those responding would accept a combination of spending cuts and tax increases. But there is substantial opposition to tax increases despite the widespread publicity about Michigan budget problems. About 30% of Michigan voters would reduce state services to avoid raising taxes. This isn't surprising as more than a third of Michigan voters believe that over 25% of state revenues are wasted. Fifty-six percent think state taxes are too high.

The survey indicated strong support for: eliminating welfare for able-bodied men and women (81%), rejecting a 4% pay raise for state employees (71%), reducing the number of state employees (67%), and allowing private businesses to provide state services (61%). The strongest opposition among the choices offered was to closing mental hospitals (75% opposed), reducing grants to foster parents taking care of needy children (69%), reducing free health care insurance for the poor (68%), and reducing welfare payments for poor women with children (62%).

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Revenues Lagging: State revenues in FY 1991 through March have lagged behind collection growth in prior years. They were well below expectations of officials in most states. According to a new survey, state tax revenue growth has only been 3.1%. The growth for the 20 largest states is shown in Table 1.

Table 1: Percent Increase Of State Tax Revenue
Fiscal Year To Date, 1991 Versus 1990, 20 Largest States

State	Percent	State	Percent	State	Percent
New Jersey	14.0%	**United States**	**3.9%**	California	1.8%
Washington	6.7	Minnesota	3.8	Tennessee	0.9
Missouri	6.4	North Carolina	2.7	Michigan	0.8
Illinois	5.9	New York	2.4	Ohio	0.8
Florida	4.5	Massachusetts	2.2	Pennsylvania	0.3
Wisconsin	4.5	Indiana	2.1	Maryland	0.1
Texas	4.3	Georgia	1.9	Virginia	-1.4

Spending Cutbacks: Both the National Conference of State Legislatures and the National Governors' Association have recently released tabulations of measures being taken to cut back state spending. In its Fiscal Survey, NGA and the state budget officers list budget-balancing measures proposed by governors, including revenue increases as well as ways to cut spending. The primary measures are listed in Table 2.

Table 2: Budget-Cutting Measures Proposed Or Implemented, 1991

Cost-Cutting Measure	Number Of States
Spending Reductions Affecting Many Agencies	
Across-The-Board	16
Targeted	24
Spending Delays Other Than Pension Funding	13
Pension Funding Delays	10
Measures Dealing With State Employees	
Hiring Freeze	22
Layoffs	11
Furloughs	7
Travel Freeze	19

The NCSL survey, State Cutback Management, includes a review of a survey from the early 1980s indicating that governors have "virtually unlimited authority to reduce the budget to avert a deficit" in about 20 states. The governor needs legislative authorization for just about any cut in about ten states. In the remainder, the governor has authority to make cuts, but there are restrictions on the power.

Biting The Hand That Feeds You? Many governors apparently didn't buy the argument that revenue-raising agencies should be exempt from cuts. A survey by the Federation of Tax Administrators identified 25 state tax agencies that had their operating budgets reduced. Cuts ranged from 1.5% to 13%.

Legislative-Executive Disputes Over Cuts: The governor's authority to make cuts without legislative action gives rise to disputes in every state. The controversies in Massachusetts, Michigan, and Pennsylvania involve particularly difficult and significant issues. In Pennsylvania, one issue is the governor's authority to close state institutions, particularly one for veterans' children. The legislature passed a bill restricting the authority. The governor vetoed it.

In Massachusetts, the legislature has sought to block institution closings and modified the governor's pay reduction plan so it covered cabinet officers. In Michigan, the Speaker and others have filed suit to block 11 fund transfers. They involve eliminating general assistance for nearly 100,000 recipients, supplementing Medicaid funding, and restoring funding for foster care, among other things.

Court Decisions Increasing State Costs: There is a continuing parade of federal and state court decisions with the impact of increasing state government costs. Legal issues in Missouri, Ohio, and the District of Columbia are a sampling.

In a federal appeals court decision in May, Missouri continued its failure to avoid escalating costs for broadly defined desegregation costs in Kansas City schools. The state has been resisting the costs on the grounds, among other things, that they drain funds from education in the rest of the state to fund education programs that are more expensive in Kansas City than elsewhere. By school finance criteria, other Missouri districts are more deserving of state aid. The state's case is summarized by the comment of an assistant attorney general: "This case isn't about black and white, it's about green." The new decision ups the state's costs for operating expenses, asbestos removal, and school construction costs.

The concept of the Kansas City case hasn't been lost on other districts, particularly St. Louis and Little Rock where the situations were somewhat similar. Other districts are looking for some of the same action. The Lorain (OH) district entered into a consent decree six years ago with desegregation plaintiffs. That decree also involved the State of Ohio which agreed to put up $1 million, which it has done. But the current costs of the program, as developed by the district, have escalated to $7 million a year. Lorain wants the state to split the higher costs with the district. So the district is now in federal district court trying to get an order requiring the state to pay.

There are about 360,000 children nationwide in foster care systems. These systems are subject to many criticisms, which are likely true to varying degrees in individual states. According to critics, the agencies dealing with foster children don't investigate child abuse on a timely basis, don't help the natural family enough so that foster care can be avoided, don't provide adequate foster care settings, have excessive caseloads for the caseworkers, don't keep adequate records, leave children in temporary settings too long, and more.

In the words of a federal district court judge, the result can be "a lost generation of children whose tragic plight is being repeated every day." The court concluded that the federal Adoption Assistance Act conferred rights on the affected children as well as establishing the federal aid program. Further, it concluded that even if a state didn't accept adoption assistance money, it was subject to judicial control because its administration of child welfare violated constitutional rights. If followed by other federal courts, this decision affecting the District of Columbia could do for federal court handling of child welfare in all states what has already happened with federal jurisdiction over state prison administration.

Medicaid reimbursement litigation is underway in many states. In Massachusetts, the nursing homes are in court seeking preliminary injunctions to preclude reimbursement cuts from being made. In many states, hospitals and nursing homes are looking for adjustments of past reimbursements as well as protection against cuts.

Impacts On Local Government: Fiscal pressures are causing major adjustments in the fiscal relations of state and local governments. The responses this year are pragmatic, but are falling into patterns. They include:

(1) Less unrestricted state aid to cities and counties. Examples are the cuts in Massachusetts and proposed cuts in Illinois and New York.

(2) Less use of the state tax system to offset part of the burden of local taxes. Examples are the reduction or elimination of the renters' credit in California, the elimination of state funded property tax relief in Maine, and the proposed elimination of the property tax deduction in Illinois.

(3) Serious efforts to reduce the mandates imposed by states on local governments. Examples are California, Massachusetts, and New York.

(4) Increasing local flexibility to use local option taxes. Old examples are local option sales taxes in South Carolina and Wisconsin. Pending examples are the shift of taxing authority and spending responsibility to California counties, proposed local sales taxes in North Carolina, new revenue options in

New York, and the proposed relaxation of Proposition 2 1/2 in Massachusetts. Existing local option sales taxes also automatically gain revenue from the many proposals to broaden the state sales tax base.

(5) A more unusual move, though conceptually similar to the others, was New Mexico's decision to end the exemption for local government sales. As a result, the state sales tax will now apply to local garbage and sewer charges, to sales by university bookstores, and to tickets to university sporting events.

Delaying Local Aid Payments: Local governments are providing flexibility for some states seeking to deal with cash flow problems or "balance" their budgets by delaying payments. This works in cash systems but not in states using generally accepted accounting principles. Michigan, confronted by an unexpected shortfall associated with court decisions on the single business tax, appears likely to delay payments to local governments, school districts, and perhaps universities. Delay also appears likely in Massachusetts, where delays would be combined with reductions in state aid for FY 1992. In New Hampshire, the latest budget balancing plan includes deferring payments of state revenue sharing funds for an entire year and phasing out the state's contribution to retirement plans of police officers, fire fighters, and teachers. New York local payments are late this spring because they depend upon a $4 billion borrowing, which depends upon enactment of the budget, which is late. New Jersey is delaying its annual payments to municipalities for replacement of revenues from the personal property tax.

Uncertain state aid payments are one of the factors causing concerns about the ability of some major cities to repay debt. See, for example, "Fear Of Big Defaults Roils Muni Markets," Wall Street Journal (5/17). Uncertainties about state aid are part of the problem in some of the jurisdictions cited -- Chicago, Detroit, New York City, and Philadelphia. But three situations not involving delayed receipt of state aid -- Washington, D.C., Massachusetts, and New York -- were also cited.

State Takeover Of Local Government: Many states have laws involving some sort of receivership for local governments. Most of these are aimed at governments with massive deficiencies in financial management. They are most often used in cases of governments with only a few employees. There are also statutes in some states reflecting the same principles, but with much more elaborate mechanisms for financial control. The model is the New York statute passed in the mid-1970s to deal with New York City financial problems through a "financial control board." That statute may be retriggered by current financial problems of the city. Other examples of use are Cleveland (OH) and Yonkers (NY). One aspect of the loan being made to the Richmond (CA) School District (see below) is state supervision of district finances.

Takeover For Policy Reasons, New Jersey: None of these arrangements are aimed at the quality or quantity of services provided by local government. The New Jersey statute for receivership of school districts is entirely different, with the takeovers based on educational failures, not financial ones. The state has already taken over the Jersey City schools. In April, it set in motion the procedures for taking over the Patterson schools. These are two of the state's largest school districts.

School Bailout In California: "A precedent for irresponsibility" was Governor Wilson's description of a California lower court's decision requiring the state to come to the rescue of the Richmond School District. The district spent at a rate it couldn't sustain for the entire school year. It announced this in April and initiated a quest for bankruptcy protection in the federal courts. The San Jose (CA) District filed in much the same way in 1983, but never went through with the process. The Richmond district had sought a loan from the state. But the state's conditions, such as the right to suspend union contracts, were unacceptable to the district.

The judge's ruling used the same rationale as the school funding cases. She concluded that by letting the district close, the state wouldn't be providing equal educational opportunities to the Richmond students. The ruling is, as far as is known to **Reports**, unprecedented. California is appealing on the basis, among other things, that such a precedent would encourage any school administrator wanting to spend more than the budget to do so and then have the state ordered to pay for completing the school year. In the words of the governor's spokesperson, the decision "sends a signal to all other school districts that they do not have to be fiscally responsible and can overspend to the point of bankruptcy and not have to worry, because the state is required to pay their bills."

The status of the litigation is uncertain. Two independently elected state officials, the Superintendent of Public Instruction and the State Controller, announced they were planning to provide a loan of $19 million to the district. They are using funds appropriated for various education programs, apparently with enough discretion in the legislation to permit the superintendent to use them for this purpose. The attorney general, on behalf of the governor, is also contesting the use of the funds, which were appropriated for a loan to another school district and for driver education. The funds were subsequently determined not to be needed for those purposes. It is unlikely that there will be a final court decision until after the funds have been spent, as the attorney general's effort to obtain an injunction failed.

CORRECTIONS COSTS AND RESULTS

> People say, "Wouldn't you rather spend the $266 million on education?" I'd rather spend it on just about anything else, but that doesn't answer the question.
>
> Comment of Wisconsin's Corrections Secretary while defending his new construction program

Corrections Costs And Inmate Increases: Corrections and Medicaid are producing double-digit increases in state budgets. Given sluggish performance of revenues from current taxes, they can be viewed as two of the major causes for cutbacks in other programs and state tax increases. The natural result is for those interested in funding for other programs and/or in avoiding tax increases to take a hard look at causes of large spending increases in these programs.

In corrections, finding the cause of higher costs isn't hard. The inmate population in 1990 grew 8.6% from 1989, according to statistics just released by the U.S. Department of Justice. Combining an 8% increase in inmates with inflation in cost-per-inmate of 3-6% (depending on such factors as food prices and employee pay increases) produces numbers for corrections operating budget increases of 11-14%. The prisoner growth rate is shown in Table 3.

Table 3: Percentage Increase In Inmates, CY 1989 To CY 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	23.0%	18	New Jersey	8.7%	34	Virginia	5.2%
2	Washington	15.4		**United States**	8.6	35	Utah	4.8
3	New Hampshire	15.1	19	Maryland	8.5	36	New Mexico	4.3
4	Texas	13.7	20	Arizona	8.3	37	Ohio	4.3
5	Alabama	13.2	21	Michigan	8.3	38	Nevada	4.1
6	Idaho	12.1	22	Wisconsin	8.3	39	Maine	3.4
7	California	11.6	23	Rhode Island	7.9	40	Indiana	3.2
8	Illinois	11.3	24	Louisiana	7.8	41	Kansas	2.9
9	Florida	11.1	25	North Dakota	7.7	42	Minnesota	2.4
10	Iowa	10.7	26	South Dakota	7.4	43	West Virginia	1.9
11	Georgia	10.1	27	Missouri	7.2	44	Colorado	1.6
12	South Carolina	9.5	28	New York	7.2	45	Nebraska	0.4
13	Wyoming	9.3	29	Arkansas	6.5	46	Delaware	-2.3
14	Kentucky	8.9	30	North Carolina	6.5	47	Tennessee	-2.3
15	Pennsylvania	8.9	31	Mississippi	6.2	48	Hawaii	-2.5
16	Vermont	8.8	32	Oklahoma	6.2	49	Alaska	-3.0
17	Massachusetts	8.7	33	Montana	6.1	50	Oregon	-4.6

The costs of the increase shown in Table 3 were substantial. Prisons added 58,808 inmates in one year. At $25,000 an inmate per year, this added about $1.5 billion to the annual corrections bill.

About another $3 billion is involved as a one-time outlay for construction of additional facilities. This makes the cost of the policies and conditions resulting in the one-year increase shown in Table 3 about $18 per capita.

Cracking Down On Crime: The policy choices driving this increase are a major issue in many states, with Wisconsin providing an example. The governor, particularly concerned by a record number of homicides in Milwaukee, called a special session in January. He sought action on eight bills, including a mandatory one-year sentence when felonies are committed with dangerous weapons. This would increase sentences in some cases substantially because Wisconsin gives judges considerable discretion in sentencing in such cases. The legislature, so far, has declined to enact the recommendations. The governor also proposed an extensive prison construction program, but the legislature countered with a citizens study panel. To avoid immediate costs, the governor suggested private construction with leasing to the state.

Policies like mandatory sentences, the length of sentences, and the use of probation and parole create massive differences among the states in the incarceration rate, the number of persons in prison per 100,000 population. Nationally, the rate is 293, meaning that about 0.3% of the population is locked up. State rates are shown in Table 4.

Table 4: Incarceration Rates, 1990

Rank	State	Rate	Rank	State	Rate	Rank	State	Rate
1	South Carolina	451	17	Ohio	289	34	New Mexico	184
2	Nevada	444	18	Missouri	287	35	Pennsylvania	183
3	Louisiana	427	19	Arkansas	277	36	Montana	174
4	Oklahoma	383	20	Virginia	274	37	Washington	162
5	Arizona	375	21	New Jersey	271	38	Rhode Island	157
6	Alabama	370	22	North Carolina	264	39	Hawaii	150
7	Michigan	366	23	Kentucky	241	40	Wisconsin	149
8	Alaska	348	24	Connecticut	238	41	Utah	143
9	Maryland	347	25	Wyoming	237	42	Nebraska	140
10	Florida	336	26	Illinois	234	43	Iowa	139
11	Georgia	327	27	Kansas	227	44	Massachusetts	132
12	Delaware	321	28	Indiana	223	45	Maine	118
13	California	311	29	Oregon	221	46	New Hampshire	117
14	Mississippi	311	30	Colorado	209	47	Vermont	117
15	New York	304	31	Tennessee	207	48	West Virginia	85
	United States	**293**	32	Idaho	201	49	Minnesota	72
16	Texas	290	33	South Dakota	187	50	North Dakota	67

State policy differences appear to be the critical variable causing the differences in Table 4. There are large differences among adjoining states. For example, the South Carolina rate is 38% above

Georgia and 71% higher than North Carolina. Minnesota ranks 49th while Michigan is seventh and Wisconsin is 40th.

Legislative Responses To Prison Cost: As indicated by the legislative response in Wisconsin, there is some aversion to further additions to the percentage of the nation's population that is locked up. Part of the concern is programmatic, resulting from suspicion that greater use of community corrections alternatives would be preferable in discouraging recidivism. Part is purely fiscal. Decisions to delay opening correctional facilities in Illinois and Michigan are an example. But legislators are reluctant to reject proposals for stiffer sentences for rape, use of weapons in commission of a crime, drug dealing, drunk driving, and second offenders. This implies a policy of financing the prison construction and operating costs associated with a stiff sentencing policy. The relief valve is the early release programs that shorten terms of those just about ready for release to make room for new prisoners.

A few states have acted to change their sentencing procedures. Delaware, for example, has a "Sentencing Accountability Commission" that has produced substantial revision of sentencing procedures and a reduction in inmates that appears in Table 3.

TAXING RICH AND POOR

Taxing The Rich: The perceived need for tax increases in many states has produced considerable interest in which income groups should bear the added burdens. Proposals to concentrate impacts on high income households are common. This was a characteristic of the income tax portion of last year's increase in New Jersey. Raising the top bracket rate is being strongly urged this year in California, Minnesota, New York, and many other states.

The objections to tax-the-rich proposals are made primarily in the name of economic development. The debate is often partisan, with Democrats supporting and Republicans opposing proposals for higher income tax rates in the top bracket. But the issue doesn't always break on party lines. For example, Governor Cuomo (D) is a major opponent of higher top bracket rates in New York.

Income Taxes: The interest in progressive taxation appears in proposals to adopt income taxes in the states that don't have them. It also appears in states with taxes that have a single (flat) rate. Flat rate income taxes are progressive (taking a higher proportion of income of higher income taxpayers) when comparing lower income taxpayers with middle income taxpayers because the value of exemptions and standard deductions is greatest proportionally for low income taxpayers. But middle income and higher income taxpayers pay about the same percentage of income in tax. As a result, there is always interest in moving from flat rates to graduated rates in the flat rate states, but no recent changes in state policy. The most serious effort this year appears to be in Massachusetts, but both legislative approval and voter acceptance of a constitutional amendment would be required for any change. The same is true in Pennsylvania, where the constitutional amendment has been voted out of committee, but with dim prospects for passage. A progressive (graduated rate) tax is being offered by some Connecticut legislators as an alternative to the governor's proposal for a flat rate.

Picking Which Tax To Raise: The impact of tax proposals on the rich and poor is also an element of debates on whether to raise income or sales taxes. Sales taxes are generally conceded to be regressive -- taking a greater proportion of the incomes of the poor than of the rich. In California, the governor's plan relies primarily on the sales tax. Legislative leaders want to make higher income taxes for the more affluent part of the budget-balancing package. The issue is also hot in Minnesota where the legislative majorities (D) are looking for an increase in top bracket income taxes, which the governor opposes. As part of the symbolism of taxing the rich, some Minnesota legislators have proposed special taxes on luxury items such as cosmetic surgery and caviar.

Assessing Who Pays State Taxes: Recently a public interest group, Citizens for Tax Justice, issued an assessment of each state's state and local tax system in terms of the tax paid by each income group as a percentage of personal income. The effective tax rate for selected states appears as Table 5. It shows state and local taxes as a percentage of incomes of the poorest income group, a middle income group, and the taxpayers with the top 1% of incomes in the state. The rank column is based on a summary measure of regressivity of state and local taxes, with the most regressive arbitrarily ranked highest. {Data for all states and methodological comments appear in Technical Notes at the end of this issue.}

Table 5: Effective State And Local Tax Rates, 1991
Taxes As A Percentage Of Income, Various Income Groups

Rank	State	Low	Middle	Rich	Rank	State	Low	Middle	Rich
2	Texas	17.1%	8.4%	3.1%	34	Massachusetts	13.6%	11.3%	8.9%
3	Florida	13.8	7.6	2.7	36	California	14.1	8.8	10.6
6	Tennessee	15.2	7.7	3.6	39	Ohio	13.4	10.0	9.6
9	Pennsylvania	15.9	9.8	5.5	41	North Carolina	10.6	9.7	8.4
10	Illinois	16.5	10.8	6.0	42	New York	14.1	13.9	11.3
17	Nebraska	16.9	11.5	8.6	44	Maryland	8.0	10.9	8.1
18	Kansas	13.2	9.7	6.8	46	Minnesota	9.5	10.5	9.6
19	Mississippi	12.9	8.6	6.7	47	Oregon	9.8	10.5	9.9
	United States	13.8	10.0	7.6	50	Vermont	7.4	9.2	9.6

Table 5 provides a sampling of contrasting state situations. The most regressive systems are found in states like Texas and Florida with no personal income tax and thus high reliance on property and sales taxes. They are followed by states with flat rate income taxes, like Illinois and Pennsylvania, or partial income taxes like the Tennessee tax on dividends and interest. High reliance on property and/or sales taxes puts states like Nebraska, Kansas, and Mississippi with higher regressivity than the national average. Low reliance on sales taxes and a highly progressive personal income tax puts states in the less regressive category.

Overall, as measured by CTJ, the state tax systems are regressive. State and local taxes take nearly 14% of the income of the poorest 20% of the population while taking less than 8% of the richest 1%. The simple reason is that consumption doesn't vary proportionally to income. A household with ten times the income of another doesn't smoke ten times as many cigarettes, register ten times as many cars, own a house ten times as expensive, or purchase ten times as much. Because state and local tax systems are heavily oriented to consumption, they tend to be regressive unless a highly graduated personal income tax is part of the mix.

Comparing Burdens Among States: Table 5 and most of the CTJ study focus on comparing the tax treatment of rich, poor, and middle income persons within the same state. For that purpose, how the tax burden is distributed is the key, not how large the tax burden is. Tax burdens are typically compared among states with an aggregate measure, like taxes as a percentage of personal income. But CTJ points out that differences among states in the distribution of tax burdens can cause a state to be a high tax state for some group, like the rich or the poor, even though overall it might not be a high tax state. Table 6 shows the states with the highest and lowest burdens for each of the income classes. The data show the top and bottom ten states in taxing each group and the taxes as a percentage of income for that income grouping in that state.

The Outlook: There is little evidence from state actions this year that there will be a dramatic change in the progressivity/regressivity of state and local taxes. The proposals that would dramatically increase progressivity by enacting an income tax and rolling back sales taxes are in trouble, but not dead, in Connecticut and Tennessee. The pattern of enactments may be those recently set in Vermont and Missouri (where tax increases are subject to voter approval). Both increase personal income taxes with an emphasis on high income individuals, a progressive move. Both increase the sales tax, a regressive move. Both increase taxes on cigarettes and/or alcoholic beverages, a highly regressive move.

Other Perspectives On Taxes: As decisions on tax policy are made in some of the larger states, they will probably follow the same pragmatic responses found in Vermont and Missouri. This isn't because state officials are deliberately deciding to have regressive tax systems. Other factors come into play, including popular preferences for sales taxes and some excises over income taxes.

Table 6: Highest And Lowest Taxes On Three Income Groups

Low Income Taxpayers			Middle Inc. Taxpayers		Richest Taxpayers	
Rank	State	Rate	State	Rate	State	Rate
1	Washington	17.4%	New York	13.9%	New York	11.3%
2	Texas	17.1	Wisconsin	13.4	California	10.6
3	Nebraska	16.9	Nebraska	11.5	Maine	10.2
4	Connecticut	16.5	Michigan	11.4	Oregon	9.9
5	Illinois	16.5	Rhode Island	11.4	Hawaii	9.8
6	South Dakota	16.2	Massachusetts	11.3	New Jersey	9.7
7	Pennsylvania	15.9	Utah	11.2	Rhode Island	9.6
8	New Jersey	15.2	Maryland	10.9	Minnesota	9.6
9	Tennessee	15.2	Illinois	10.8	Ohio	9.6
10	Indiana	14.8	New Jersey	10.8	Vermont	9.6
41	Nevada	10.0%	Alabama	8.5%	Alabama	5.1%
42	Oregon	9.8	Texas	8.4	New Hampshire	3.8
43	Minnesota	9.5	Tennessee	7.7	Tennessee	3.6
44	Wyoming	9.0	Florida	7.6	South Dakota	3.5
45	Hawaii	8.7	New Hampshire	7.6	Washington	3.4
46	Maryland	8.0	Montana	7.4	Texas	3.1
47	Delaware	7.4	Delaware	7.0	Florida	2.7
48	Vermont	7.4	Nevada	5.7	Alaska	2.5
49	Montana	7.1	Wyoming	5.3	Wyoming	2.4
50	Alaska	5.3	Alaska	3.1	Nevada	1.8

South Carolina's Assessment: A recent tax study report in South Carolina, besides offering an example of a quality review of a state's tax policy, illustrates the range of considerations other than regressivity that affect decisions on taxes. The 158-page report assesses South Carolina policy systematically against the principles for state revenue systems developed by a NCSL task force in 1987. The report suggests the state will have difficulty in capturing two major growing sources of economic activity. To eliminate this concern, it suggests broadening the sales tax base to services and the income tax base to some retirement income. In recognition that South Carolina is no longer a rural/agricultural state, it suggests strengthening the role of local revenues including giving school boards more flexibility in raising property taxes. For cities and counties, it proposes adding alternatives to the local option sales tax, including a local piggyback income tax and local motor vehicle taxes.

HEALTH CARE ISSUES

State Plans To Expand Health Care Access: In April, Governor Castle (DE) briefed a Congressional committee on the Governors' Association work on health care, which is expected to lead to policies for the governors to adopt in their meeting in August. The governors hope to have something constructive to say about reform at the federal level and to outline some options for state policy. Some of those are designed to cut the overall costs of health care: (1) "managed" care, (2) tort reform, and (3) all-payor fee setting arrangements resulting in the same payments for the same service by Medicaid, private health plans, and private patients. Many of the recommendations being considered are designed to shift costs from a narrow base to a broader one. One example is spreading high-cost coverage over all insurers, as is now done in risk pools in auto insurance.

This hasn't been a year for enactment of new programs to expand health care for the uninsured, except as necessary to comply with federal mandates to expand Medicaid coverage. But the level of legislative concern, and frustration, remains high. One indicator came in April in Missouri. The House health committee brought a Canadian-style health plan to the floor. The plan had features opposed by many involved in health care politics, like substituting the state for others as the buyer of care for everyone. It also had a stiff tax, 7.5% of payroll. Notwithstanding these features, the bill garnered 63 votes to an opposing 86. A measure to create a Health Care Commission with extensive regulatory powers passed the Florida House, but emerged from conference committee and passed as establishing a working group charged with making a study.

Federal Action On Health Care: Health care concerns in Congress mount along with health care costs and perceived problems, but no action appears likely anytime soon. Speculation about federal action presumes no action on any of the national health care proposals before the elections of 1992.

Limiting Malpractice Costs: The Bush Administration has announced it will push legislation to control medical malpractice costs. The draft legislation unambiguously takes positions on tort law issues now in the hands of state legislatures. The policies favored include: (1) limits on pain and suffering awards, (2) "structured settlements," rather than lump sum payments to victims, and (3) pre-litigation mechanisms like arbitration. Under the legislation, the federal government would set standards for the operation of medical licensing boards. Trial lawyers objected because they don't like the proposals. State officials were concerned about preemption of their authority and financial penalties if they don't comply with the federal mandates. Hospital officials worried that states wouldn't follow the guidelines and the penalties would be extracted from them.

Federal Medicaid Costs: Fixed cost-sharing percentages mean federal Medicaid costs move in lockstep with state costs. So it wasn't surprising that OMB Director Darman expressed concern that the federal costs were "exploding." He cited growth in the federal share from a previously estimated $40 billion to more like $50 billion in federal FY 1991 and a further escalation in FY 1992 to almost $65 billion. He announced a crash study to determine what was causing the growth. Much of the emphasis appears to be in predicting the cost increases more accurately, rather than in preventing the cost increases.

There isn't any secret about Medicaid cost escalation. State officials have experienced several years of it. They have extensive data on who the recipients were, who the vendors were, what the costs per case were, etc. The primary reasons for cost increases: (1) increasing recipients for many reasons including recession, federal mandates of coverage, and extended coverage of AFDC providing automatic Medicaid coverage, (2) escalation in the cost per unit of service, such as hospital days, and (3) more extensive service such as greater use of expensive tests. State officials have underestimated these factors. Costs have also been underestimated systematically in some states (e.g., California, Michigan, New York) to show balanced budgets and in expressions of hope that various cost control measures would work. To the extent that federal budget officials have relied on the state estimates, these state misestimates have become federal misestimates as well.

It is unlikely that any of the factors affecting the Medicaid estimates has been unknown to federal officials who work with Medicaid. So there is some concern among state officials that the federal mini-study may have something to do with restrictions on Medicaid bootstrap financing (see next article).

As the federal investigation of the causes of cost increases was getting underway, a federal decision further increased cost. Clozapine, a drug to treat schizophrenia at a cost of $6,000 a year, is now part of the Medicaid drug program nationwide.

Non-Medicaid Free Care Pools: The many arrangements developed by individual states to pay for unreimbursed hospital care are tending to become unhinged. The costs involved are those incurred by hospitals and not recovered from patients, insurers, or government programs such as Medicare and Medicaid. They consist of costs for the uninsured and portions of costs for insured persons that are represented by deductibles or not covered under the policies involved.

In Florida, one of the major issues this year was whether to provide for added financing requirements by a tax on hospital services, "a sick tax" as opponents see it, or a general tax of some sort such as motor vehicle fees. The result was a compromise, involving a little of each. In New Jersey, the legislature refused to renew a surcharge of about 19% on all hospital bills. As a result, each hospital has its own surcharge. Surcharges add more than 50% to the bills of some urban hospitals but less than the previous 19% to hospitals serving more affluent areas. Predictably, consumers are beginning to respond by directing business to the hospitals with the lower surcharges. Certain union health and welfare funds are initiating litigation over hospital charges, arguing that federal Employee Retirement Security (ERISA) legislation precludes state policies which lead to large surcharges.

In Massachusetts, the high costs and rapid growth of the "free care/bad debt pool" were two of the factors leading to passage of the universal care legislation in 1988. That law included a cap on the size of the pool. With universal care down the tubes, the governor has recommended removing the cap. The action would make consumers, primarily employer health plans, pay an extra $79 million a year through their hospital rates.

Medicaid As A Middle Class Benefit: The extent to which Medicaid has become a portion of retirement and health care planning for higher income Americans is indicated by a Business Week (5/20) feature, "Before You Settle On A Retirement Community." The article discusses long-term care (nursing home) insurance policies, noting they "cost a pretty penny." It then notes that personal financial planners can help find alternatives and quotes a tax attorney who "recommends transferring assets to a child or other trustee so you can meet the net-worth limits for Medicaid." A similar article appeared in the Wall Street Journal (5/23) with citations to books like The Medicaid Planning Handbook and Avoiding The Medicaid Trap. Some of the devices, like irrevocable trusts, are complex. Others are simple. For example, entering a nursing home with a $200,000 house, a $100,000 mortgage, and $100,000 in investments requires the liquidating of the stocks to pay the nursing home before Medicaid eligibility can be established. But using the investments to pay off the mortgage first protects their value, because there is an exemption for homes in Medicaid's asset test.

Connecticut has long had an expensive approach to nursing home care under Medicaid, paying an average of $109 a day, fourth highest in the nation. State law mandates that care be identical regardless of whether Medicaid or private funds pay the bill. According to the New York Times (5/14), nursing home operators say this removes incentives for people to pay their own way, "Why give up a lifetime of savings if it makes no difference in care?" The state has tried to cope by limiting the number of nursing home beds, but this has created waiting lists and illegal side payments to gain admission. The new budget seeks to cut costs by limiting reimbursement rates to care defined as essential in medical terms, reducing, for example, the number of recreational programs.

Medicaid Solutions: New York's comptroller recently suggested that the state deal with its Medicaid problems by having an independent commission run the program. He argues:

> This nearly three-decades-old multi-headed budget-busing monster must be removed from the hands of a crazy-quilt bureaucracy and the political decisionmaking process if it is to be brought under control. Drastic action is needed now before Medicaid wrecks our public finances and our health system as well.

For the larger states, it is much too early to tell how the mandated growth in Medicaid services will be paid for. Overall, it will be a difficult-to-quantify mixture of (1) higher taxes, (2) lower spending for other programs than would have been the case without the mandates, and (3) reductions elsewhere in Medicaid. The trade-off is relatively clear in Utah, which has already enacted its budget for FY 1992. The mandates will add young children and pregnant women whose incomes are above welfare levels. The money to serve them is being made available by eliminating about 3,000 adults who have slightly too much income to receive cash assistance. Other Medicaid recipients will find Utah is dropping optional services so they will have to pay for their own hearing aids, glasses, and dentistry.

MEDICAID BOOTSTRAP FINANCING

Medicaid Cost Shifting: The federal inquiry on Medicaid costs raises the question of whether there is more than just improving cost predictions on the federal agenda, such as attempting to revive proposals to shift more of Medicaid costs to the states. Administration attempts to shift costs were common in budgets of the 1980s, but consistently rejected by the Congress. The substance of the plans was to have a greater percentage of costs paid by states. The mechanics varied from proposal to proposal.

Bootstrap Financing: One new issue may become the hottest federal-state fiscal issue of 1991 and 1992 -- the practice **Reports** calls Medicaid "bootstrap financing." The National Conference of State Legislatures calls it "states' use of provider taxes and voluntary contributions to enhance state Medicaid matching funds." NCSL concludes in its Federal Update (5/24) that the Administration has launched "a major offensive" against the practice.

In simple terms, a health care provider puts up the state share of Medicaid costs. It earns a federal share and both shares are returned to the provider. The arrangements differ in whether the contributions are voluntary or compulsory, the numbers of types of providers involved, and whether the money is "laundered." If providers contribute to a fund that is used directly to obtain the federal match with contributions proportional to Medicaid business, the tie is most direct. If a tax is involved independent of Medicaid business (e.g., 3% of hospital gross revenue) and the money goes to a state's general fund, the tie is highly indirect.

Rapid Growth Of The New Financing Plans: Making a long story short, federal officials have long taken the position that voluntary contributions couldn't be used as a Medicaid match. A few states (e.g., Tennessee) pioneered in bootstrap financing devices. Other states expressed interest, but federal officials were arguing with states using the procedure over disallowing their claimed match. Congress has placed a moratorium on disallowances, good through 1991. The moratorium, budget pressures, and the apparent success of states that tried the device led to spreading use.

The Health and Human Services Inspector General calculates the federal loss from "creative" state schemes at $2.5 billion in this fiscal year. State officials using the practice defend it on the merits and as a way to deal with their desperate fiscal problems caused by rising costs, caused in part by federal mandates. HealthWeek (5/20) described the situation as, "States Outfox Feds For Medicaid Cash."

Current Use Of Bootstrap Financing: According to the Health Care Financing Administration, bootstrap financing is costing about $2.5 billion in federal funds, about five times as much as in FY 1990. The practice is concentrated in a few states as shown in Table 7.

Table 7: Federal Costs Of Medicaid Bootstrap Financing, FY 1991

	Federal Cost ($ million)	
State	Donations	Provider Taxes
Massachusetts	$307	
Pennsylvania	292	
Alabama	288	
Texas	244	
Tennessee	224	
Kentucky		$221
Florida		189
South Carolina		161
Missouri	130	
North Carolina	110	
New York		102
California	68	
Ohio		65
Georgia	56	
Maryland		28
Hawaii		1
Washington	*	
Idaho	*	

* Less Than $1 Million.

Rapid Expansion Of The Financing Plans: Adopting bootstrap financing arrangements where they don't exist and expanding them where they do is one of the major efforts to reduce net Medicaid state costs being considered in the legislatures this year. They have already been adopted in some states (e.g., Arkansas and Maryland) with projections of budget balance based on their anticipated effects.

Bootstrap financing plans are pending in many legislatures as ways to solve budget problems. In Massachusetts, the governor has been assuring a nervous treasurer and the public that the state won't have to borrow during FY 1991 because of an expected payment of $489 million in Medicaid reimbursements. In Oregon, legislators and the governor are considering a tax on hospitals or all health care providers to raise the extra money for their Medicaid plan revisions. Both houses of the Alabama legislature have passed a dedicated tax covering hospitals, nursing homes, and prescription drugs.

The Illinois Hospital Association is pushing for revisions in hospital reimbursement that would cost an estimated $300 million annually. The plan is being sold to the Illinois legislature as costless -- the hospitals put up $150 million which triggers federal matching funds for the other $150 million.

Ohio And The Coming Collision: Ohio provides an example of what is developing in the industrial states and its implications for Medicaid financing nationwide. It also illustrates why and how the states are quickly forcing a major federal decision. Ohio is just an example. There are similar moves afoot in other states.

The governor has proposed a budget premised on no major tax increases and a balanced budget. Many legislators don't like the spending consequences, such as eliminating general assistance, but don't want tax increases either -- or want them but don't think they can get them enacted. Ohio already has bootstrap financing at a relatively modest level, based on an 0.5% levy on hospitals. It is seen as drawing an extra $50 million of federal Medicaid match. After initial reservations, the Ohio Hospital Association likes the idea. The chairman of the House health committee has a bill to expand the arrangement, upping the tax to a maximum of 5% and covering other health care providers. The estimated impact is $400 million more in Medicaid match. The idea looks so good that it is likely to be incorporated in the House budget legislation, making it possible to continue the general assistance program.

Ohio has about 4.4% of the nation's population. If other states take similar action, the national result would be about 23 times Ohio's $400 million or a total federal tab of around $9 billion. This has obvious budget implications for the federal government. It also has the state and federal policy implication of making the Medicaid program more extensive than it would otherwise be. For states like Ohio, the consequences of any federal policy that rejects this type of match after January 1, 1992 are substantial as well.

EMPLOYEE BENEFITS

Calculating the employer costs of benefits provided to workers in all state and local governments is a time-consuming task. The Census Bureau has just released its results for 1987 as part of the 1987 Census of Governments. The data in Government Costs For Employee Benefits are somewhat dated, but the relative generosity of state and local benefits is likely to be stable over time. Table 8 shows the percentage of payroll in each state represented by employee benefits, particularly Social Security and retirement contributions and health insurance plans.

Table 8: Costs Of Employee Benefit Plans As Percent Of Payroll
State And Local Governments, October 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	29.5%	15	Tennessee	23.2%	34	Iowa	19.4%
2	Pennsylvania	29.2	19	Ohio	23.0	35	Arizona	19.3
3	Connecticut	27.6	19	Wyoming	23.0	36	New Hampshire	19.2
4	Maryland	27.4		**United States**	**22.8**	37	Arkansas	19.1
5	Utah	26.9	21	Florida	22.6	38	Colorado	18.9
6	Delaware	26.4	22	North Carolina	22.4	38	Nebraska	18.9
7	Hawaii	25.5	23	New Jersey	22.2	40	Illinois	18.6
8	Rhode Island	25.0	23	West Virginia	22.2	41	South Dakota	18.4
9	Oregon	24.8	25	Virginia	21.9	42	Missouri	18.3
9	Wisconsin	24.8	26	Oklahoma	21.8	43	North Dakota	18.1
11	Washington	23.9	27	Alabama	21.6	44	Kansas	18.0
12	California	23.8	28	Montana	20.6	45	Mississippi	17.8
13	Nevada	23.5	29	Minnesota	20.5	45	Texas	17.8
14	Massachusetts	23.4	30	Vermont	20.2	47	New Mexico	17.3
15	Alaska	23.2	31	South Carolina	20.1	48	Indiana	17.1
15	Maine	23.2	32	Georgia	19.9	49	Kentucky	16.5
15	Michigan	23.2	33	Idaho	19.5	50	Louisiana	16.1

Considered in conjunction with information on employee cash compensation (States In Profile, Table E-19), these data suggest that states where wages are high also have expensive benefit plans. By comparison with other states, they are doubly expensive because (1) costs are higher as a percentage of wages and (2) wages are higher. For example, New York is third highest in average state and local pay and also first in costs of benefit plans shown in Table 8. Connecticut is fourth in wages and third in benefit plans. The converse is also true. Benefit costs are low percentages of wages in Arkansas, Mississippi, and South Dakota. In these states, the benefits cost a lower percentage of the lower wage, so per-employee costs are considerably lower.

MISCELLANY

Economic Development: Asked to identify the state's #1 problem, 38% of Michigan respondents picked the economy/jobs, up from 19% last October. Crime/ drugs was second (18% down from 30% in October) and education third (13% down from 19%).

Federal Preemption: There is a sizeable collection of bills with serious chances of passage by the Congress that preempt state and/or local laws on various subjects. The proposed Surface Transportation Assistance Act of 1991 limits state authority in trucking regulation as well as regulating, through grants, state highway department operations. The President has made a new proposal that would require states to conform to federal policy in their medical malpractice laws. The proposed revisions of interstate banking laws preempt state branch banking regulation.

State-Local Fiscal Relations: Robert Strauss (Carnegie-Mellon U.) discusses "State-Local Finance: Rethinking Service Delivery and Taxing Authority," in NCSL's Fiscal Letter (March/April). He offers several principles such as having the level of government responsible for financing a service set benefit levels. Taxpayers and legislatures have set up another set of principles in tax and expenditure limits. These are assessed statistically by Philip Joyce (Congressional Budget Office) and Daniel Mullins (Indiana U.) in the Public Administration Review (May/June). They conclude that the limits on states have had little effect. Limits on local governments seem to have had the effect of encouraging state aid. This is consistent with attempts to raise local restrictions in states from Alabama to Massachusetts.

Wetlands: State policies for dealing with wetlands and the ecological and federal regulatory climate influencing the policy choices are the topic of Wetlands Protection And The States (National Conference of State Legislatures). The 26-page summary finds examples of regulatory programs in Florida, Michigan, New Jersey, North Carolina, North Dakota, and Virginia. Some states have acquired wetlands and there are special property tax concessions for landowners preserving wetlands in Iowa, Minnesota, and New Hampshire.

Items: The heavy involvement of some state pension funds in takeover activities of Kohlberg, Kravis, Roberts & Company is the subject of "Gambling With The Big Boys" in The New York Times Magazine (5/5). Author Sarah Bartlett, who has written a book on KKR operations questions "whether public pension funds should be investing in such high-risk deals." She does make a case that KKR made considerable money, thereby reducing returns to the participating pension funds, but doesn't suggest the pension fund returns were below alternative investments. States mentioned for heavy involvement are Illinois, Iowa, Massachusetts, Michigan, Minnesota, Montana, New York, Oregon, Utah, Washington, and Wisconsin.

The Kansas involvement in risky investments caused the governor to appoint herself to the retirement system board earlier this year. She has now decided to resign based on changes in investment administration she finds acceptable.

When awards for landing on your feet are given, the former superintendent of the Richmond (CA) district that declared bankruptcy will probably be a winner. Walter Marks was associated with the district's overspending (as well as the innovative education programs for which the money was used). He got a severance payment of $93,990 to buy out his contract and a new job running the Kansas City schools. The award for not landing on your feet was given by the Federation of Tax Administrators to the Massachusetts Department of Revenue for "excellence, creativity, and innovation." The award was for handling administration of the state's extension of the sales tax to services -- a law which was repealed retroactively after being in effect for a few days.

The Florida legislature passed several bills this year with purposes that aren't obvious from the bills' provisions. One permits prostitutes to sue their pimps to get back earnings pimps take by coercion. A reasonable guess is that without the bill courts wouldn't entertain such suits because the money was illegally obtained in the first place. Then there was the bill passed to make it illegal to impersonate a state legislator. **Reports** is not aware of how widespread this problem is or of the adverse public consequences flowing from such impersonations. Perhaps some Florida legislator found a solution to having to be in two places at once and his colleagues didn't like it. Or maybe local comedians were doing impersonations. Or maybe ???

TECHNICAL NOTES

State Budget Developments: The Michigan poll was done for Public Sector Consultants (300 S. Washington Sq., Lansing, MI 48933). The tax revenue survey is from the Center for the Study of the States (Rockefeller Institute of Government, 411 State St., Albany, NY 12203). The complete data appear in its State Revenue Reports (May). The 50-state version of Table 1 appears in State Budget & Tax News (Issue 12).

Crime And Corrections: The inmate and incarceration statistics are from the Justice Department's release "Prisoners In 1990." The statistics include some federal prisoners while excluding prisoners sentenced for under one year who are found in local jails in most states but in state prisons in some circumstances.

State Tax Policy: The Citizens for Tax Justice (1311 L St., NW, Washington, DC 20005) report is titled A Far Cry From Fair. The results for each state appear in Table A-1. The last three columns are the actual data presented in the study -- the percentage of income estimated to go to state and local taxes by residents of each state in each of the three income brackets. The summary is only part of the data in the study, which include average tax rate information for seven income brackets for 1985 as well as 1991. In addition, data for 1991 are presented for each income group for each state for each major tax (personal and corporate income, property, sales, and excise) along with the offsetting impact of deductibility of some taxes from income subject to federal tax.

There are varying ways of measuring regressivity and progressivity of taxes. These all involved some judgements beyond a conclusion that taxes should be progressive. For example, for a tax system to be progressive a household with income of $50,000 should pay more than twice as much tax as a household with an income of $25,000, but should it pay 2.1 times as much, or 2.2, or 2.3? CTJ avoided this problem by not using an overall measure, which tends to keep the study above criticism for arbitrariness, but makes it hard for decisionmakers to make comparisons with other states, unless they happen to be in one of the states CTJ calls the "terrible ten."

To make comparisons possible, **Reports** created an arbitrary but simple regressivity measure. Table A-1 ranks states on this measure, with the most regressive tax systems appearing highest. By counting from the bottom readers have a ranking based on progressivity. The third column shows the percentage by which the effective tax rate on low income persons exceeds that of middle income persons. For example, for the U.S. the 13.8% rate for low income persons is 38% higher than the 10% rate for middle income persons. If each group paid about the same effective rate, the third column would show zero, which is about what appears for New York (#42) Only six states have progressive tax systems in this comparison. Column 2 is the same calculation for rich and middle income taxpayers. Column 1 sums the two.

The tax study report, Financing Government In The Palmetto State, is from South Carolina's Advisory Commission on Intergovernmental Relations (P. O. Box 12395, 1333 Main St., Columbia, SC 29211).

Health Care: A fine summary of recent proposals for national health policies, including mandating expansion of Medicaid, takes up most of the May 15 issue of the Journal Of The American Medical Association. The American Association of Retired Persons (1909 K St., NW, Washington, DC 20049) has issued Reforming The Health Care System: State Profiles 1990. The 161-page publication is almost entirely devoted to three pages of statistics on each of the states, with comparisons to national averages. The U.S. General Accounting Office (Washington, DC 20548) has issued a new 57-page report, Health Insurance Coverage: A Profile Of The Uninsured In Selected States. The conclusions aren't surprising: "The likelihood of being uninsured in the United States is greater among young adults, minorities, unmarried people, and those with less than a high school education."

Table A-1: Effective State And Local Tax Rates, 1991

State		Total	Index Of Regressivity Middle/Rich	Index Of Regressivity Low/Middle	Effective Tax Burden Low	Effective Tax Burden Middle	Effective Tax Burden Rich
1	Nevada	292	217	75	10.0%	5.7%	1.8%
2	Texas	274	171	104	17.1	8.4	3.1
3	Florida	263	181	82	13.8	7.6	2.7
4	Washington	262	179	83	17.4	9.5	3.4
5	South Dakota	235	148	86	16.2	8.7	3.5
6	Tennessee	211	114	97	15.2	7.7	3.6
7	Wyoming	191	121	70	9.0	5.3	2.4
8	New Hampshire	167	100	67	12.7	7.6	3.8
9	Pennsylvania	140	78	62	15.9	9.8	5.5
10	Illinois	133	80	53	16.5	10.8	6.0
11	Connecticut	115	42	74	16.5	9.5	6.7
12	Alabama	107	67	40	11.9	8.5	5.1
13	Indiana	102	52	49	14.8	9.9	6.5
14	Alaska	95	24	71	5.3	3.1	2.5
15	Louisiana	95	48	47	14.1	9.6	6.5
16	Missouri	94	52	43	13.0	9.1	6.0
17	North Dakota	91	35	56	13.3	8.5	6.3
18	Nebraska	81	34	47	16.9	11.5	8.6
19	Kansas	79	43	36	13.2	9.7	6.8
20	Mississippi	78	28	50	12.9	8.6	6.7
21	Michigan	75	50	25	14.3	11.4	7.6
22	Arizona	75	26	49	14.3	9.6	7.6
	United States	**70**	**32**	**38**	**13.8**	**10.0**	**7.6**
23	Colorado	64	45	19	11.0	9.3	6.4
24	Georgia	63	35	29	13.0	10.1	7.5
25	Arkansas	59	19	40	13.2	9.4	7.9
26	Oklahoma	59	38	21	12.2	10.1	7.3
27	Utah	59	36	22	13.7	11.2	8.2
28	Virginia	56	32	24	11.8	9.5	7.2
29	New Jersey	52	11	41	15.2	10.8	9.7
30	Iowa	52	22	30	12.5	9.6	7.9
31	Kentucky	50	25	25	12.5	10.0	8.0
32	Wisconsin	49	58	-8	12.3	13.4	8.5
33	New Mexico	49	9	39	13.1	9.4	8.6
34	Massachusetts	47	27	20	13.6	11.3	8.9
35	Rhode Island	43	19	25	14.2	11.4	9.6
36	California	43	-17	60	14.1	8.8	10.6
37	Idaho	42	9	33	12.8	9.6	8.8
38	West Virginia	40	1	39	12.9	9.3	9.2
39	Ohio	38	4	34	13.4	10.0	9.6
40	South Carolina	32	13	19	10.5	8.8	7.8
41	North Carolina	25	15	9	10.6	9.7	8.4
42	New York	24	23	1	14.1	13.9	11.3
43	Maine	24	-8	32	12.4	9.4	10.2
44	Maryland	8	34	-27	8.0	10.9	8.1
45	Montana	2	6	-4	7.1	7.4	7.0
46	Minnesota	0	9	-10	9.5	10.5	9.6
47	Oregon	-1	6	-7	9.8	10.5	9.9
48	Hawaii	-10	5	-16	8.7	10.3	9.8
49	Delaware	-11	-17	6	7.4	7.0	8.4
50	Vermont	-24	-4	-20	7.4	9.2	9.6

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June 1991 (Second of Two June Issues)

THE DEVELOPMENT IMPERATIVE

Assessing Development: While they work on the immediate problems of balancing state budgets, state officials are beginning to look more intently at the relationship between state policy and economic development. There is plenty of incentive to look. As unemployment and fears of unemployment become widespread, jobs and income soar in polls about public concerns, surpassing such issues as crime, the environment, and even taxes. As experts testify on the reasons why economic problems are driving revenues down and spending up, elected officials can see the advantage of solving budget problems by development rather than by either spending cuts or tax increases.

Development, The Painless Solution: From the perspective of state capitols, success in economic development has obvious appeal. Given a choice between getting 3% more revenue by 3% extra economic growth or a 3% tax increase, the political cost of the growth alternative is clearly less. So is the economic cost, because adding revenues by a growing economy doesn't take purchasing power away from current taxpayers. Economic growth is also a more comfortable social policy. In a stagnant economy, trying to find jobs for welfare recipients or new high school graduates isn't easy. In a vibrant economy, many of these people will find jobs with no government program. Growth is vital for social welfare spending as well, a point often made by Governor Cuomo in dealing with New York budgets. Attempts to increase social spending that require significantly higher taxes, he argues, tend to undermine the private sector growth that is ultimately the source of revenue to sustain state social programs.

Jobs And Recession: The recession has been taking its toll on jobs. Nationwide, from March 1990 to March 1991 there was a decline in the number of jobs. There were major differences among states as shown in Table 1. Nineteen states experienced job loss overall. The number grows to 22 if only private sector jobs are considered. A reasonable target for job growth is that it should reflect about the 1% annual increase in population. By that measure, only 19 states made the grade. Most of them are less populous states. Of the ten largest states, only Texas showed job growth of 1% or more.

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Table 1: Percentage Change In Employment, March, 1990 and 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nebraska	4.76%	18	Iowa	1.45%	34	Pennsylvania	-0.37%
2	Idaho	4.69	19	Montana	1.28	35	Maryland	-0.43
3	Utah	4.27	20	Oklahoma	0.97	36	Florida	-0.46
4	Nevada	4.11	21	Kansas	0.96	37	North Carolina	-0.54
5	Louisiana	3.01	22	Alabama	0.95	38	Missouri	-0.59
6	Washington	2.92	23	New Mexico	0.87	39	Georgia	-1.10
7	Arkansas	2.87	24	Wisconsin	0.78	40	Delaware	-1.16
8	South Dakota	2.79	25	South Carolina	0.74	41	Virginia	-1.48
9	Arizona	2.52	26	Mississippi	0.53	42	New York	-1.93
10	Colorado	2.39	27	Ohio	0.39	43	Connecticut	-2.00
11	North Dakota	2.24	28	West Virginia	0.24	44	New Jersey	-2.04
12	Alaska	2.08	29	Illinois	0.14	45	Michigan	-2.86
13	Hawaii	2.02	30	California	0.09	46	Vermont	-2.91
14	Wyoming	1.95	31	Minnesota	0.03	47	Rhode Island	-3.05
15	Oregon	1.59	32	Indiana	-0.10	48	Maine	-3.43
16	Texas	1.49		**United States**	**-0.12**	49	New Hampshire	-4.79
17	Kentucky	1.46	33	Tennessee	-0.29	50	Massachusetts	-4.93

Development Strategies: Most of the articles in this issue assess what is happening as state officials seek simultaneously to expand their development efforts, maintain their spending patterns for education and social services, and restrain tax increases.

A Strategy For Massachusetts: Massachusetts, with some of the worst economic problems in the nation, recently was offered a development plan by Harvard Business School professor Michael Porter. He joined legislators at a press conference to announce the proposals being incorporated in state legislation this year. Porter wrote The Competitive Advantage Of Nations which has attracted national attention for its discussion of American competitiveness. He also wrote a special report, The Competitive Advantage Of Massachusetts. It appeared in April, perfect timing to influence the omnibus budget legislation.

Porter's view of government's role rejects both a *laissez-faire* view in which the free market reigns and an industrial policy of government support for specific critical industries. He suggests, "Government's proper role is creating the *environment* in which firms compete." He sees state and local government as a powerful level because of influences on education, specialized training, and infrastructure, as well as taxes and regulation. Some of his specific recommendations are:

Get The Fiscal House In Order: He calls dealing with the state deficit the first priority, noting, "Perhaps the most pernicious aspect is a lack of confidence which sends ripple effects throughout the economy." He endorses productivity measurement, privatization, and priority for education spending. In the press conference, he said Massachusetts should be "the most fiscally conservative state in the union." This, he suggested, would attract capital, reduce the cost of borrowing, and restore and maintain confidence.

Encourage Investment: For private investment he endorses favorable tax treatment of capital gains and research and development credits. He suggests the state "sweep away the barriers to installing fiber optic, cellular, satellite, and/or other leading-edge communications capabilities which are the best of any state in the union."

Push Energy Conservation: He says the state should turn high energy costs into a strength, as Japan has. He urges the state become a model for the nation in environmental regulation.

INDEX OF STATE ECONOMIC MOMENTUM

The New Results: The West does best in the new Index of State Economic Momentum shown in Table 2. Every one of the top 15 states is West of the Mississippi River. Every one of the bottom ten is East of that dividing line.

Table 2: Index Of State Economic Momentum, June 1991

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	5.44	18	Florida	0.61	34	Indiana	-0.38
2	North Dakota	2.93	19	Maryland	0.52	35	Virginia	-0.39
3	South Dakota	2.65	20	Arkansas	0.50	36	Pennsylvania	-0.62
4	Washington	2.52	21	New Mexico	0.41	37	West Virginia	-0.73
5	Utah	2.48	22	Wisconsin	0.32	38	Tennessee	-0.74
6	Idaho	2.15	23	Kentucky	0.29	39	Missouri	-0.75
7	Alaska	2.02	24	Louisiana	0.23	40	Illinois	-0.98
8	Arizona	1.84	25	North Carolina	0.21	41	Connecticut	-1.00
9	Hawaii	1.66	26	Wyoming	0.10	42	New York	-1.01
10	Nebraska	1.16		**United States**	**0.00**	43	New Jersey	-1.14
11	California	1.14	27	Georgia	-0.14	44	Maine	-1.22
12	Oregon	1.12	28	Ohio	-0.21	45	Delaware	-1.28
13	Montana	1.12	29	Minnesota	-0.21	46	Rhode Island	-1.36
14	Texas	1.12	30	Alabama	-0.25	47	Michigan	-1.40
15	Colorado	0.83	31	Oklahoma	-0.31	48	Vermont	-1.60
16	South Carolina	0.81	32	Iowa	-0.35	49	Massachusetts	-1.87
17	Kansas	0.61	33	Mississippi	-0.38	50	New Hampshire	-2.50

The Index was developed by **Reports** as an up-to-date measure of how each state is doing economically relative to other states. It compares population growth, personal income change, and job growth. A high ranking indicates success in achieving economic development objectives and a state that is likely to be in a relatively strong fiscal position.

Keys To Success: The states which are doing much better than the national average have avoided massive recession effects by having something special going for them. Nevada is still experiencing a residential building boom while gambling industry employment holds up well. The Dakotas shot to the top of the Index because of federal farm support payments. Washington is living on success of key firms, like Boeing and Microsoft. Farm, ranch, and oil patch states are doing reasonably well. The Midwestern industrial states are suffering less in this recession than previous recessions, though Michigan has moved into the bottom five because of heavy job losses. Except for Michigan, all of the bottom ten states are in the Northeast.

Tax Increases And Economic Momentum: When national economic conditions are poor, more states adopt tax increases than in prosperous times. Because the Index ranks states *relative* to national conditions, it won't indicate the prevalence of poor state fiscal conditions. But it does suggest where they are worst. Of the ten states on the bottom, New Jersey adopted a major tax hike last year, seven states are clearly on the way to major tax increases this year, and two states (Massachusetts and Michigan) have governors trying against substantial odds to avoid increases. Tax increases aren't on the table in the top ten states in the Index excepting three with special situations: Nebraska (with the special property tax replacement problem described in this issue), Nevada, and South Dakota.

CORPORATE HEADQUARTERS LOCATIONS

Importance Of Headquarters: Having the headquarters of major corporations is a major advantage for a state. In addition to the favorable publicity they generate, headquarters operations are usually non-polluting and impose few demands on state and local government services. Other facilities, such as R&D centers, are often located near the headquarters. They generally employ a large well-paid staff which in turn provides a strong local tax base and a good source of active community leaders.

Counting Headquarters: Every Spring the major business periodicals publish their lists of the largest corporations in America. Each has its own definition of largest: Fortune (6/3) uses sales, Business Week (spring bonus issue) uses market value, and Forbes (4/29) compiles four separate rankings, using sales, net profits, assets, and market value. These firms are large -- the smallest firm on the

Fortune 500 Industrials list had assets of $116 million and sales of $546 million. Large well-established firms do not move their headquarters casually. Particularly in the last decade, changes in the make-up of these lists were often caused by mergers and acquisitions. As a result, states were more likely to gain headquarters by growing a company onto the lists of large firms than by a corporate move and to lose headquarters by merger or reorganization than by a relocation of an existing firm.

State Comparisons Of Headquarters: The list of states with the most headquarters is dominated by the larger industrial states. Using either Business Week's 1000 or Fortune's combined industrial and service lists, which total 1000, New York and California each have over 90 headquarters, followed by Illinois, Texas, Ohio and Pennsylvania with more than 60 each.

Tables 3 and 4 show the number of companies per million population in each state. Table 3 uses the combined Fortune rankings. Table 4 uses the Business Week list.

Table 3: Fortune Combined Service And Industrial 1000 Headquarters Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Connecticut	14.0	17	Arkansas	3.8	34	Iowa	1.8
2	Delaware	10.6	18	Hawaii	3.6	35	Utah	1.7
3	New York	7.5	19	Wisconsin	3.5	36	Florida	1.6
4	Minnesota	7.5	20	Indiana	3.4	37	Oklahoma	1.6
5	Illinois	7.3	21	Oregon	3.2	38	South Carolina	1.4
6	Rhode Island	6.0	22	California	3.2	39	West Virginia	1.1
7	Ohio	5.8	23	Washington	3.1	40	Kentucky	1.1
8	Massachusetts	5.3	24	Idaho	3.0	41	Maine	0.8
9	Missouri	5.2	25	Maryland	2.9	42	Mississippi	0.4
10	Pennsylvania	5.0	26	Colorado	2.7		Alaska	0
11	New Jersey	4.8	27	New Hampshire	2.7		Montana	0
12	Nebraska	4.4	28	Kansas	2.4		Nevada	0
13	Virginia	4.3	29	North Carolina	2.1		New Mexico	0
14	Georgia	4.1	30	Alabama	2.0		North Dakota	0
	United States	**4.0**	31	Arizona	1.9		South Dakota	0
15	Texas	3.9	32	Louisiana	1.9		Vermont	0
16	Michigan	3.8	33	Tennessee	1.8		Wyoming	0

Table 4: Business Week 1000 Headquarters Per Million Population

Rank	State	Number
1	Delaware	12.0
2	Connecticut	10.9
3	Illinois	6.6
4	Minnesota	6.4
5	New York	6.4
6	Idaho	5.9
7	Ohio	5.9
8	Massachusetts	5.8
9	Pennsylvania	5.3
10	Missouri	4.9
11	Georgia	4.6
12	Oregon	4.6
13	Colorado	4.5
14	New Jersey	4.5
15	Texas	4.2
16	Nevada	4.1
17	Washington	4.1
18	Rhode Island	4.0
	United States	**4.0**
19	California	3.6
20	New Hampshire	3.6
21	Hawaii	3.6
22	Virginia	3.4
23	Iowa	3.2
24	Alabama	3.2
25	Oklahoma	3.2
26	Michigan	3.0
27	Maryland	2.9
28	Utah	2.9
29	Indiana	2.9
30	Wisconsin	2.8
31	Louisiana	2.6
32	South Carolina	2.6
33	Arkansas	2.5
34	Nebraska	2.5
35	Maine	2.4
36	Kansas	2.4
37	North Carolina	2.1
38	Tennessee	1.6
39	Kentucky	1.6
40	North Dakota	1.6
41	Florida	1.3
42	Montana	1.2
43	Arizona	1.1
44	New Mexico	0.6
45	Mississippi	0.4
	Alaska	0
	South Dakota	0
	Vermont	0
	West Virginia	0
	Wyoming	0

About the same results appear whichever table is used. The long-established industrial states of the East and Midwest tend to lead in corporate locations. California and Texas are about in the middle of the pack. Rural states generally have few corporate headquarters; many have none.

Over short periods of time, the rankings are stable, as can be seen by comparing Table 4 with the comparable table for 1990 (States In Profile, Table B-18). Delaware and Connecticut switched places. New York dropped and Minnesota and Illinois moved up in rank.

But firms which are joining the roster for the first time aren't in exactly the same states as older firms. The Fortune 500 Industrials, the most widely-quoted ranking of firms, added 35 new firms located in 15 different states. Only 5 of the "big 6" states cited above were there -- Ohio had no new firms join the list. Connecticut, Minnesota, Nebraska, Washington, Michigan, Kansas, New Jersey, Wisconsin, Iowa and New Hampshire made up the rest of the newly added firms.

A different measure of a state's success at developing corporate headquarters is a list such as Business Weeks's 100 "Hot Growth Companies" (5/27). These 100 fast-growing firms are located in 23 states. California leads the list with 22 firms, followed by Texas with 13. But states which are not well represented in the rankings of corporate giants appear here, including Minnesota (7), Colorado (5), Florida (4), and Georgia (4). Most states had none of these companies. Those that did have fast-growing firms are shown in Table 5.

Table 5: Business Week 100 Hot Companies Per Million Populatio

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Utah	1.7	9	New Hampshire	0.9	16	Oregon	0.4
2	Minnesota	1.6	10	Texas	0.8	17	Florida	0.3
3	Colorado	1.5	11	California	0.7	18	Pennsylvania	0.2
4	Massachusetts	1.3	12	Georgia	0.6	19	Louisiana	0.2
5	Nebraska	1.3	13	Tennessee	0.6	20	New York	0.2
6	Rhode Island	1.0	14	Arizona	0.5	21	Wisconsin	0.2
7	Oklahoma	0.9	15	Washington	0.4	22	Illinois	0.2
8	New Jersey	0.9		United States	0.4	23	Michigan	0.1

This listing is quite different from those of Tables 3 and 4. On Table 5 and similar listings are found states like Oregon, Utah, Minnesota, Massachusetts, and Texas as well as California.

Foreign Competition: These rankings consider only U. S. firms. As markets become more global, it is possible for a state to be doing well relative to other American states, but be doing poorly in world competition. Forbes compiled its four lists for the ten largest companies in the world. Using assets as a criterion, all ten are banks and none are American. Only three US firms make the list based on sales, four based on market value, and four based on profits. The dominant country on all of these lists except profits is Japan. Japanese banks account for nine of the ten largest asset-based firms (Barclays is the other). Japanese firms hold six spots on the sales list, five on the market value list, but only one (Toyota) on the profitability list.

THE DEVELOPMENT REPORT CARD

Why A Report Card?: The Corporation for Enterprise Development (777 North Capitol St., NE, Washington, DC 20002) has come a long way with its ranking system, The 1991 Development Report Card For The States. The report card concept began to give state policy makers an alternative to business climate studies that stressed low taxes and policies that discouraged unionization. The report card stressed fairness in tax policy, investments in infrastructure and education, and government policies of encouraging development. It tended to result in rankings which were directly opposite from the business climate rankings. One result has been to more or less eliminate simple conclusions about business climate from policy discussions, making the rankings more a subject for technicians.

The designers of the Report Card tried to keep their product simple. But there are now some 150 data elements entering rankings in four categories with multiple subcategories and several special analyses. The result is a bit more than the report card parents would expect children to bring home from school. Report Card is 156 pages, about 8,000 data elements, and comes with an electronic version requiring a reasonably expensive computer to run. {Many **Reports** readers have the capacity to handle this complexity and will find Report Card to be both interesting reading and a valuable resource.}

State Grades On The Report Card: There are four principal summary grades in the report reflecting performance on indices of: economic performance, business vitality, development capacity, and state policy. Table 6 shows the states that scored well by showing those with two or more grades of "A." The states with single "A" grades were Hawaii, Indiana, Iowa, Maine, Massachusetts, Michigan, Nevada, North Carolina, Ohio, and Pennsylvania.

Table 6: States With CfED Report Card Grades Of "A", 1991

"A's"	Performance	Vitality	Capacity	State Policy
4	Connecticut	Connecticut	Connecticut	Connecticut
4	Maryland	Maryland	Maryland	Maryland
3		California	California	California
3		Minnesota	Minnesota	Minnesota
3	New Jersey	New Jersey	New Jersey	
2		Colorado	Colorado	
2	Delaware		Delaware	
2	New Hampshire	New Hampshire		
2		New York		New York
2		Utah	Utah	
2	Washington		Washington	
2	Wisconsin			Wisconsin

The leading scorers are Northeastern industrial states and California. They benefit from the Northeastern economic prosperity that faded too late to affect the data used to measure performance and vitality. They also benefit from government policies assessed by CfED as being desirable, such as graduated income taxes. The losers, shown in Table 7, generally lack these policies. They are also states with economies that didn't perform well in the late 1980s.

Table 7: States With CfED Report Card Grades Of "F", 1991

"F's"	Performance	Vitality	Capacity	State Policy
4	Louisiana	Louisiana	Louisiana	Louisiana
3	West Virginia	West Virginia	West Virginia	
2	Kentucky		Kentucky	
2	Mississippi		Mississippi	
1			Arkansas	
1	Montana			
1				Nebraska
1				New Hampshire
1				New Mexico
1		North Dakota		
1		Oklahoma		
1				South Dakota
1		Wyoming		

STADIUMS AND ECONOMIC DEVELOPMENT

Introduction: Professional sports teams are getting major new concessions from cities and states. Governments are looking to hold the sports franchises they have while governments without franchises are trying to attract existing teams as well as new franchises. The situation leads to large public subsidies because towns (and states) seem to love their team more than their team loves their town. With the teams willing to move and the communities viewing keeping them as a matter of economic development as well as civic pride, the offers have escalated.

Critics Of Subsidies: There are some dissenters. New Jersey has aggressively worked to move teams from adjoining New York and Philadelphia, with success in moving New York teams to the Meadowlands. Philadelphia has kept its teams including the basketball 76ers and the hockey Flyers. A complex deal is afoot to satisfy both teams with a new arena. It would be privately financed but the state would spend $3 million to demolish an existing stadium. The facility would, under a recent state law, pay no property taxes for five years, and the city would provide a garage for arena parking. But the two candidates for Philadelphia mayor don't like the deal. One opposes the use of city funds for the garage. The other, former Mayor Frank Rizzo, commented:

> I am against funding anything in the area of sports. The owners of these teams are zillionaires. They've got all kinds of money, and they expect us to fund a new stadium. ... You can rest assured that they're not going to get any money from me.

The criticisms are not confined to Philadelphia. Gerald McEntee, the head of the American Federation of State, County and Municipal Workers, commented in Public Employee (June/July) on unnecessary spending that was taking resources from functions he considered more essential. His list of places to look for waste included contractors and consultants, special districts, and new construction -- "Are new sports arenas and convention centers and the like really essential right now or should we make sure that poor kids can be fed and vaccinated?"

Journalistic assessments tend to be critical, with titles suggesting the content of the articles -- "Take Me Out To The Cleaners," Business Week (5/6), "The Latest Municipal Malady: Convention Center Fever," New York Times (2/24), "Wrecking Ball Hits Convention Center Myths," City & State (2/11), and "City's Taxpayers Have Tiger By The Tail," Detroit News (12/23/90).

Academic assessments of cost-benefit analyses of stadiums also tend to be negative as typified by "Just Say No? The Economic And Political Realities Of A Small City's Investment In Minor League Baseball," Economic Development Quarterly, (May, 1991). Authors Mark Rosentraub and David Swindell (both Indiana University) talk of "big boys wanting big toys" at someone else's expense.

The criticisms extend to public marketplaces, often a part of convention center projects, as indicated by "After The Festival Is Over," Governing, (August, 1990). The article carries the subtitle: "Like Toledo, scores of cities have built glitzy festival marketplaces in an effort to cure downtown commercial blight. But in many of them, the cure isn't working very well." For convention centers, there is also criticism from trade groups of the use of public money to compete with private enterprise. In May, the International Communications Industries Association, the Exposition Service Contractors Association and the International Exhibitors Association criticized publicly supported centers for providing services available in the private sector.

Current Issues: One of the major debates over the Missouri budget this year concerned appropriating $5 million to contribute to construction of a domed stadium in St. Louis and sports facilities benefiting the Kansas City Royals (baseball) and Chiefs (football). In the Detroit area, the competition comes locally between the central city and the suburbs, as well as between the Detroit and other cities. The Tigers (baseball) want a new stadium at a cost of some $200 million. The Pistons (basketball) and Lions (football) already play in the suburbs. The Milwaukee Brewers are looking for money from Wisconsin to replace their stadium.

Other American league teams have gotten their deals already. The Chicago White Sox are in a new Comiskey Park and the Baltimore Orioles are expected to occupy their new stadium next year. Both were built with substantial government funding. Convention center support was an issue in Georgia this year, also in Missouri and other states.

Economic Assessments: The Heartland Institute has been active in assessing the economics of taxpayer support of convention centers, stadiums, and sports teams in a series of studies (see Technical Notes). While the conclusion is controversial, there appears to be a pattern for most projects. The economic feasibility assessments of the backers of major sports and convention center projects tend to be positive, even enthusiastic. The academic assessments tend to be negative. The operating results tend to be mixed, with cash flow often less than predicted but argument over the magnitude of indirect benefits (e.g., promoting tourism) and intangible benefits such as civic pride and "putting a community on the map."

Economically one would expect competition among states and cities vying for sports teams and convention business to drive down the cost teams and center users must pay for use of facilities. Who gets the resulting subsidy value isn't clear. Probably it results in lower costs for holding conventions, but in the case of sports events benefits may accrue to franchise owners as well as to sports fans. Whoever gets the subsidy value, it is true that the communities and states with the facilities will get the convention and sports traffic. The question is how much traffic is generated and how the money would otherwise have been spent.

The Politics of Stadium And Convention Center Subsidy: Regardless of the economics, these kinds of investments generate considerable enthusiasm among state officials. As the Governors' Bulletin described the situation in an enthusiastic article (8/90):

> The bases are loaded and the states are at bat swinging for high economic return for their investment dollars in sports complexes. More and more states are realizing the lucrative economic benefits that can be derived from investment in sports complexes. In many states, public financial investment in sports complexes is being viewed as an economic development tool.
>
> This kind of investment not only brings back dollars to the public coffers through direct economic impact but also can afford states a variety of indirect benefits such as: increasing national exposure, increasing tourism, offering a spirit of rejuvenation to economically depressed areas, and giving rise to an overall cultural renaissance.

COMPETITION IN TAX POLICY

Competition In Economic Development: Recession has meant there has been little activity in constructing new plants that would provide a basis for competition among the states. But the development competitors are in place, including an estimated 9,000 state and local development agencies. Finding a way to quantify whether the incentives being offered are growing would appear nearly impossible. But Time magazine in a feature on development (5/27) estimates that incentives are twice what they were ten years ago and that the average government price for a new job is $50,000.

Assessing Competition: Public finance experts have traditionally taken a dim view of the impact of competition for business on the national patterns of state fiscal policies. This view, reflected in a 1981 report, saw competition among the states as a zero-sum game. To the extent that states altered tax policies in the name of competition, the effect was likely to be lower taxes and thus lower spending. Tax policy was likely to be biased against taxes on businesses and taxes reflective of ability to pay, particularly graduated personal income taxes.

An alternative view is reflected in a new report by the federal Advisory Commission on Intergovernmental Relations, Interjurisdictional Tax And Policy Competition: Good Or Bad For The Federal System. The ACIR suggests that competition is less frowned upon than it was when its earlier report was issued. The report suggests that competition does serve as a regulator of state conduct. Among other things, it encourages investments in infrastructure and education and creates incentives to keep overall government costs down.

Competition And Tax Policy: The new report concludes that current research "confirms the tendency for interjurisdictional competition to reduce reliance on ability-to-pay taxes." It also notes continued criticism of state industrial development incentives through tax policy. But it cites research indicating that tax policies do affect business location decisions. It suggests that the "old model" of using economic development incentives may be changing. It says Colorado's economic development plan exemplifies "some of the more encouraging trends in state and local policies," such as moving away from an emphasis on industrial recruiting -- words obviously written before the competition for United Airlines began.

The United Airlines Competition: The competition for a United Airlines maintenance facility is hot. Oklahoma City has adopted a 1% sales tax to pay for its offer. Illinois and its local governments are reportedly offering $300 million.

The giant offer is one about to be offered to the Colorado legislature. The plan offers credits of $500 to $2,000 per year per employee. While not called a subsidy in local debate, the tax credits would result in cash payments from the state to the airline in years when the credits exceeded the company's tax liability. A substantial debate has developed over whether granting the tax concessions would be cost effective.

Tax Incentives In Massachusetts: Massachusetts is in the poorest position of any state to consider tax cuts. Its credit rating is the worst in the nation. Its voters only narrowly defeated a ballot measure last November to roll back taxes. Its pension plans are about the most underfunded in the nation. Its pre-FY 1991 budget imbalances were turned into debt, with interest and principal burdening current budgets. Its FY 1991 budget is out of balance. Its FY 1992 budget is way out of balance and the governor is pledged to block tax increases. So if Massachusetts elected officials are considering tax cuts, there must be a reasonably compelling case at least as they see the situation.

This spring the governor proposed several tax cuts to encourage business. The major proposals would provide credits for investment and for research and development that corporations could offset against their income tax liabilities. The governor decided that he wouldn't press for enactment this year in light of the fiscal situation. In May, the House Ways and Means Chairman unveiled the legislative alternative to the governor's budget. It called for tax credits for research and development as well as less specific commitments to eliminate unnecessary business regulation, spur innovation, and to put Massachusetts in the forefront in providing business incentives. With support from the governor and legislative leaders, some version of business incentives like these would appear to have a good chance of passage this year and an excellent chance within the next several years.

Tax Incentives In Maine: New business tax credits to spur investment were also recently proposed by Maine's governor. The fiscal climate for them was in one way even less favorable than in Massachusetts. In Massachusetts, the proposals were criticized as not being affordable and providing business tax breaks when the Commonwealth was cutting its help for the poor. These criticisms apply in Maine along with one more. Unlike Massachusetts, the Maine proposals are part of a package raising taxes, including the sales tax. One way of looking at the package is that new taxes on average Maine residents were being levied to finance tax breaks for Maine corporations. But the Republican governor's investment credit proposals "have won unusually warm support from Democratic legislators," according to Maine's leading newspaper. Similar proposals have been made by Maine Democratic leaders in the past.

Tax Incentives In Missouri: Missouri also offered new tax concessions for development in the same session in which it raised taxes on individuals and corporations. The new law authorizes 18 new enterprise zones, adding to the 39 already established since Missouri started using them in 1982.

STATE FINANCES IN POOR SHAPE

Overview: The fiscal circumstances of most states deteriorated seriously all spring. Monthly revenue reports showed tax revenues running below estimates, even those estimates that had already been revised downward. Lagging revenues at the end of FY 1991 encouraged estimators to revise downward their projections for FY 1992 revenues. While revenues dropped, spending escalated with rising costs in Medicaid and corrections and failure of cost cutting measures, like hiring freezes, to bring the savings anticipated.

The result appeared in dramatic revisions of fiscal projections. California's estimated budget gap moved from the $7 billion announced in January to $12.6 billion in the early spring to $14 billion in May. Similar revisions were made in other states with budget bills pending, such as Delaware, Maine, and Pennsylvania. In some of the states with budgets already enacted, such as Florida, the revisions triggered new actions to attempt to bring budgets back in balance.

Recovery And State Budgets: The critical question in building the FY 1992 budgets is how quickly the recession will end and how robust the recovery will be. The continuing passage of time without signs of recovery is causing some state officials to recast their assumptions. This was the basis for Governor Casey's decision to up the size of his proposed Pennsylvania tax increase. As he put it:

> A recession which was forecast by economic experts just months ago to be mild, shallow, and brief is no longer being described in these terms. Based on our actual tax receipts so far, we see no hope for substantial improvement in the near term.

Late Budgets: One impact of the bad news has been to delay budget decisions. Some legislators were unwilling to vote for the cuts that would be required to enact a balanced budget without major tax increases. Others were unwilling to vote for the tax increases to avoid the cuts. The combination of these forces sometimes precluded pulling together a working majority to pass a budget and tax package. The task is even more difficult in states where extra-large majorities are required to pass the budget (e.g., California) or enact emergency clauses so tax measures can go into effect quickly. As a result, states like California, Massachusetts, and Vermont missed informal deadlines for early enactment of their budgets -- deadlines related to the need to get revenues from tax increases and savings from budget cuts flowing quickly.

As New York passed June 1 without a budget, it was setting new records for extending the process beyond the April 1 beginning of its fiscal year. Other states may have this problem, such as California, which missed its deadlines last year, and Illinois where there is talk of a long hot summer.

Consequences Of Late Budgets: Questions arise when late budgets become a possibility. These are the common ones and the answers.

How common is going past the beginning of a fiscal year? In the 1980s, the federal government often didn't adopt budgets on time. It sometimes went an entire fiscal year without final budgets for some agencies. In 1983, all federal agencies operated on continuing resolutions, with no final budget ever enacted. The states act much more rapidly, but going beyond the beginning of the fiscal year by up to a week occurs in a few states every year. Occasionally states go longer. For example, Ohio didn't adopt its final budget until late December of 1971, halfway through the fiscal year in which it made the controversial decision to adopt an income tax.

Is it legal? Federal and state constitutions have provisions saying in substance that no money shall be spent except pursuant to appropriation. In some states and at the federal level, ancient statutes and presumed emergency powers provide some credence to the claim that some outlays (e.g., keeping prison guards on the job) can be made as emergencies, but most of the claims are weak. In interim periods before budgets are enacted, the states and federal government enact appropriations bills for short periods known as continuing resolutions or emergency appropriations. Sometimes players essential to enactment of an appropriations bill -- the governor or leaders of one house -- deny approval for these bills to increase pressure for passage of the final measure. Then the press reports the state has "run out of money." Actually it has run out of appropriation authority.

What are the disadvantages? If a state were operating with stable tax and spending policy, the only disadvantage would be uncertainty about the final budget outcome and the public perception that state elected officials couldn't get their work done on time. If the new budget is to include tax increases, the state loses revenue from delayed enactment. Other consequences -- benefits of employee pay raises, savings from spending cuts, starts of new projects and programs -- are also delayed. Special problems arise, as they did in New York and could in Massachusetts and Pennsylvania, when the state or a major local government needs to go to the financial markets.

What would make legislatures act in time? Timely legislative action is most likely when the end of the legislative session is set constitutionally well before the end of the fiscal year, primarily a practice of the less populous states.

Pressures For Tax Increases: The deteriorating fiscal circumstances of many states have clearly upped the pressures for major tax increases. Decisions by three governors provide examples.

In Maine, Governor McKernan (R) had consistently maintained Maine could operate without any tax increase despite its economy which mirrored the rest of New England. He recently recanted in a big way, proposing increases in many Maine taxes, suggesting increases in business aid and public works spending, and rejecting some budget cuts he had previously endorsed. Governor Ashcroft (R) in his opening message to the Missouri legislature opposed tax hikes with a possible exception for education reform. Presented with solid legislative support for increases, he entered the negotiations to reduce the size of the hikes and add education reform, then endorsed the resulting package. In Pennsylvania, Governor Casey (D), who campaigned in 1990 on the basis of no tax increases, proposed increases in January but avoided broad based taxes. He recently upped the ante with a proposal for a major income tax increase.

How Large Will State Tax Increases Be? There will be no systematic compilation of state tax increases until the National Conference of State Legislatures publishes its traditional preliminary one in August. Even then, it will be hard to assess the year because some states -- such as Florida, Tennessee, and Texas -- may be acting in August or later for various reasons. The current guess among state fiscal experts is that the total annual yield of state tax increases enacted this year will be around $17 billion. This is a large number: (1) about the same as the first year revenue from the federal tax increase of 1990, (2) over $65 per capita, (3) nearly $150 for every American worker, and (4) over a 5% increase in state general fund taxes.

Fatherless Taxes: Concern over being responsible for tax increases has added to the popularity of the tax for which no elected official is responsible. Such taxes have been rare in state fiscal history, but the device is becoming more popular. One common example is the minimum school property tax required for participation in state aid. Georgia provides an example of state action to raise this local tax. The Texas school legislation achieves this result in a complex way by creating new regional taxing districts. South Carolina has a local option sales tax for counties that redistributes money among counties much as a state tax would do. To avoid a state tax, which the governor opposed, but raise state purchasing power for highways, which many Floridians wanted, Florida last year adopted a local option gas tax that really isn't optional. This year Minnesota adopted a local option surcharge on the sales tax. The option not to levy it is linked with the option to lose all state aid.

Local Tax Increases: One consequence of fiscal problems at the state level will be fiscal problems at the local level. Some states will shift their difficulties by aid cuts as well as more subtle means, such as limiting the flow of prisoners from local jails to state prisons. The impacts of state actions will often compound difficulties in local finances stemming from other causes, such as economic downturn. The shifting is most obvious in Massachusetts and New York. The new budget legislation in New York makes cuts below prior year levels in both aid for schools and aid to cities and counties. In Massachusetts, there have been delays in making state payments to local government, cuts in past years, and more cuts contemplated in the current budget.

Avoiding local aid cuts and the perceived property tax increases that go with them has been an objective of those considering tax increases in some states. This was a major motivation of the tax bill passed in Kansas, which was vetoed by the governor as not providing enough property tax relief.

Implications Of The Tax Increases: In every recession, tax burdens, measured as the percentage of personal income taken by state and local taxes, rises. The growth of tax revenue drops as income and sales lag, but property taxes remain steady or rise and governments tend to raise tax rates as they are doing this year. While the taxes rise, personal income rises more slowly. The tax burden statistic reflects a real burden for taxpayers who find their property and other taxes more burdensome to pay while unemployed or earning less income. But, for the taxpayer, there has traditionally been relief with economic recovery. While personal incomes rise sharply, taxes rise less sharply and if 1984-85 is a guide, some states actually roll back some of their earlier tax increases.

Whether taxpayers will get the same relief when this recession ends isn't clear. Some of the tax increases are being offered with "temporary" components like the California sales tax proposal and part of the Vermont increase. But other tax increases are not, nor logically would they be in the many cases where they are offered as solutions to structural budget deficits (e.g., California), to finance permanent improvements in education (e.g., Arkansas and Missouri), or to shift burdens from local to state taxes (last year in Nebraska).

Mortgaging The Fiscal Future: The use of "one-time" measures will influence how many of the state tax increases will be temporary and will increase pressures for future tax increases. The one-time measures reap current savings or revenues at the expense of future costs or revenue flows. There is no way to quantify their use over 50 states. However, they seem to be extraordinarily popular this year.

Despite last year's disavowal of future non-recurring items, New York's new budget as proposed by the governor had $200 million in payments to the state from the transit agency serving New York City, over $100 million in accelerated tax collections, and over $100 million from selling state assets including selling the Aqueduct Race Track to the Port Authority. As enacted, the total is $625 million of one-time items, with bonding added to the list.

INCREASING GOVERNMENT'S SHARE

Government And Private Employment: Despite all the media coverage of financial hardships in government leading to layoffs, employment in the public sector is much more stable than private sector employment. This is shown by Table 8.

Table 8: Government And Private Employment Change, March 1990-1991

Sector	Employment (000)		Change	
	1990	1991	(000)	Percent
Private Sector	89,956	89,567	-389	-0.43%
Government Sector	18,586	18,844	258	1.39%
Total	108,542	108,411	-131	-0.12%

Responding To Recession, Individual States: The growth in public employment in states with the worst economic problems is large enough to be embarrassing to those seeking to demonstrate austerity in public spending. For example, New Hampshire and Rhode Island both expanded public employment by over 2% in the last year -- while private employment was dropping 4% in Rhode Island and 6% in New Hampshire.

Table 9, which was derived by **Reports** from federal data, shows sharp contrasts among the states in how employment change has occurred in both public and private sectors. The private employment change shown closely resembles the total employment change shown in Table 1. The difference is that government employment has been taken out of the total and shown separately, leaving private employment. Both are shown in Table 9 along with the difference between the two, which is a measure of how states are tracking private employment change with public employment change.

There is a tendency for public employment to remain stable or even grow a little reflecting population growth and new programs. Nationwide this led to growth of about 1.4% for the year ending in March. With a drop of 0.4% in private employment, the spread shown in the table is 1.8%. If government employment were constrained to match private employment changes, the spread would be zero.

Table 9: Percent Growth In Employment, March 1990 And 1991

Rank State	Spread	Public	Private	Rank State	Spread	Public	Private
1 New Hampshire	8.60%	2.54%	-6.06%	26 Indiana	1.32%	1.02%	-0.30%
2 Rhode Island	7.22	3.16	-4.06	27 Alabama	1.18	1.89	0.71
3 Nevada	6.50	9.80	3.30	28 Louisiana	1.17	3.94	2.77
4 South Carolina	6.20	5.78	-0.42	29 Wisconsin	1.16	1.76	0.60
5 Vermont	4.61	0.90	-3.71	30 Tennessee	0.72	0.31	-0.41
6 Florida	4.14	3.04	-1.10	31 Iowa	0.65	1.97	1.33
7 New Jersey	3.29	0.73	-2.56	32 Colorado	0.47	2.77	2.30
8 North Carolina	3.21	2.16	-1.06	33 Hawaii	0.38	2.32	1.94
9 Georgia	3.17	1.50	-1.67	34 Mississippi	0.25	0.72	0.47
10 Arizona	2.99	4.98	1.98	35 Pennsylvania	0.21	-0.19	-0.40
11 Michigan	2.89	-0.45	-3.33	36 Oklahoma	-0.05	0.93	0.98
12 Virginia	2.67	0.65	-2.02	37 Kansas	-0.24	0.77	1.01
13 Minnesota	2.42	2.05	-0.37	38 Kentucky	-0.65	0.94	1.58
14 Connecticut	2.41	0.09	-2.32	39 Illinois	-0.80	-0.54	0.26
15 Idaho	2.20	6.41	4.22	40 New Mexico	-0.83	0.26	1.09
16 California	2.14	1.88	-0.26	41 Arkansas	-0.95	2.09	3.04
17 Texas	2.09	3.20	1.10	42 Wyoming	-1.00	1.24	2.24
18 Maine	2.09	-1.73	-3.82	43 Nebraska	-1.18	3.81	4.99
United States	**1.82**	**1.39**	**-.43**	44 West Virginia	-1.49	-0.94	0.55
19 Oregon	1.70	2.98	1.28	45 Delaware	-1.98	-2.86	-0.88
20 New York	1.62	-0.61	-2.22	46 South Dakota	-2.18	1.10	3.28
21 Maryland	1.59	0.85	-0.74	47 Montana	-2.26	-0.41	1.85
22 Massachusetts	1.58	-3.56	-5.14	48 Utah	-2.42	2.37	4.79
23 Washington	1.57	4.20	2.63	49 North Dakota	-3.41	-0.30	3.12
24 Ohio	1.44	1.61	0.17	50 Alaska	-3.87	-0.56	3.32
25 Missouri	1.37	0.56	-0.81				

If the numbers can be believed (see Technical Notes), the states at the top of the list have been expanding government jobs at the same time that private sector job markets have been contracting. This suggests that austerity hasn't affected government much. In New Hampshire, this is probably because so much of state and local employment is local employment financed by property taxes.

Nationwide, public jobs grew more than private ones in percentage terms in 35 states. Three situations were involved. First, in the most common case state and local employment grew while private employment declined. Second, in a few cases, like Nevada, both public and private jobs grew, but public ones grew faster. Third, in a few cases there were employment cutbacks in both public and private sectors, but the loss of jobs was greater in the private sector. This category includes some states with prominent fiscal problems that did affect state and local employment -- Michigan, Maine, New York, Massachusetts, and Pennsylvania.

The 15 states shown with a negative spread saw private employment grow more (or drop less) than state and local employment. This is a strong, but not conclusive, sign that these states will be avoiding future fiscal problems.

MISCELLANY

Bullet Trains: The Texas High-Speed Rail Authority has awarded a franchise to a consortium that expects to provide bullet train service connecting Dallas, San Antonio, and Houston. The $6.7 billion plan contemplates tax-exempt financing, but no state appropriations. The franchise doesn't guarantee construction, but gives the group a hunting license to bag financing. Bullet train systems have been discussed in other states, particularly Florida.

Income Taxes: Proposals for income taxes in states that don't have them haven't won acceptance anywhere, but some haven't lost either. The Connecticut legislature passed a bill emphasizing expanding the sales tax base as an alternative to the governor's income tax proposal. The governor vetoed it, with override considered unlikely. Florida's legislature has adjourned with minor tax increases but agreement that "tax reform" will be on the agenda for a special session later this year and/or next year's session. New Hampshire legislators are pursuing other alternatives, but having difficulty raising the money they think they need. Texas legislators will meet in the late summer to consider budget and tax issues.

Medicaid Bootstrap Financing: The idea of having health care providers pay the state share of Medicaid through contributions or earmarked taxes is spreading rapidly. Officials of states that haven't been using the practice are asking why they shouldn't get on the bandwagon. An example was the discussion at the New Jersey Senate Revenue, Finance and Appropriations Committee budget hearing on Human Services in mid-May. The agency head said his staff was assessing use of the device to recoup money associated with the Uncompensated Care Trust Fund. One senator, quoting the legislative budget staff, suggested that an added $200-300 million a year could be tapped by the financing device.

In Pennsylvania, hospitals are going to be borrowing $365 million to make their contribution. Pennsylvania counties which run nursing homes are working on a borrowing pool to raise $173 million. Once put in motion, arrangements like these will be difficult to unwind. Federal decisions to disallow Medicaid reimbursements would be nearly tantamount to decisions to force state tax increases or major curtailment of Medicaid coverage. Probably for that reason, Gail Wilensky, head of the Health Care Financing Administration, is making a public case against bootstrap financing. She told the Philadelphia Inquirer (5/17), "What the states are doing ... is not right and ought not to occur." She indicated she wouldn't object if Congress wanted to increase the federal share of Medicaid costs, but "What I object to is this sort of under-the-table way the states are doing this .. It's bad public policy."

The consideration of the issue has apparently escalated within the federal government, with OMB a party to the decisions along with the Health Care Financing Administration. Expanding health care access argues for permitting bootstrap financing. Avoiding a sharp rise in federal outlays argues against. The major issue to be decided is whether to renew the legislative moratorium against regulations to prohibit the financing. A related issue is whether to allow Massachusetts to make retroactive claims. Massachusetts officials want quick reimbursement because the money, up to $489 million, is assumed as helping balance the FY 1991 budget and avoiding new borrowing. The legislative moratorium isn't scheduled to expire until the end of the year.

Nebraska Taxes: "New York is not Nebraska." former New York Senate Majority Leader Warren Anderson told the New York Times (6/2) as a way of explaining why it was hard to complete action on the New York budget on schedule. Nebraska probably does have it easier because the unicameral legislature means no conference committees. But in terms of tough issues and executive-legislative disagreements, Nebraska outranks most states by about any measure. Last year's passage of major tax hikes, the governor's veto, the veto override, and having the hikes considered and nearly rejected by the electorate provided more excitement than in the average state.

Now Nebraska officials fear local governments will lose all property tax revenues. Replacing them would require a doubling or tripling of the state sales tax or about doubling the income tax. The problem is complex and descriptions themselves controversial. Over the years, Nebraska like other states has granted exemptions (e.g., business inventories) to the property tax, primarily for personal property. Claiming under federal legislation prohibiting state tax discrimination against them, railroads, then pipelines and telephone companies got their taxes lowered. Now, claiming under the clause of the state constitution requiring uniformity in property taxes, four legislators on behalf of homeowners have sued. Their argument is that so many breaks have been provided to personal property that real property taxation is unconstitutional. The fact of the litigation, which is unlikely to be resolved quickly, means the property tax collections are uncertain.

In May, the governor suggested a special election to adopt an amendment to the state constitution. Resolving the issue is difficult substantively and politically because every alternative has differing ramifications for individual school districts and thus for individual households and businesses. The concept of the governor's plan is to exempt all personal property from taxes this year. Tax ideas on the table include a sales tax on farm and business utility purchases, reducing the fee retailers get for collecting the sales tax, a "depreciation surtax," and even raising sales and/or income taxes.

Property Tax Discrimination: Nebraska's problems won't necessarily prove unique to Nebraska, but won't be nationwide. They arise out of a common state, not federal, constitutional provision that property taxes be uniform for all property. Other states that have run afoul of this requirement have solved their problem by either restoring uniformity in assessments or amending their constitution to permit classification, with different assessment practices for different types of property.

The remedy of amending the state constitution isn't available if the constitution being violated by state property tax practice is the federal constitution. It contains no provisions on property taxes *per se*, but does have provisions on interstate commerce and an equal protection clause that sometimes has been held to protect economic as well as civil rights. The equal protection clause was at issue in an case (R.H. Macy v. Contra Costa County) which the U.S. Supreme Court recently agreed to hear. Under threat of boycott, Macy's withdrew. But the Court might accept companion cases presenting issues for California homeowners comparable to those involving California businesses. Another business parallel to Macy's is likely to reach the Court sooner or later.

In 1978, California adopted Proposition 13, an initiative designed to limit property taxes. It operates by limiting increases in assessed value except when property changes hands. The result is that neighbors have different assessments reflecting 1975 values for those still in the home they owned when Proposition 13 passed, 1985 values for those who bought ten years later, and 1991 values for those who buy this year. So neighbors in essentially identical houses may pay twice or even three times the taxes of other neighbors. Macy's has been competing since 1967 in the same mall as Penny's and Sears and paying about the same taxes until 1986 when Macy's underwent a corporate reorganization that was a change of ownership under California law. Now Macy's is assessed about $58 a square foot while its competitors are assessed about $21. Macy argues this is so unfair as to violate the U.S. Constitution.

California's formal freezing of assessed values until property changes hands is a rare practice. However, in some states informal procedures produce similar results. Properties are infrequently reassessed and assessors are not aggressive in pushing assessed values to full market values, but do move the assessed value to market values when properties are sold. It was this practice in West Virginia that caused the U.S. Supreme Court to find its procedures unconstitutional in a 1989 case.

TECHNICAL NOTES

Employment: The Bureau of Labor Statistics provides the monthly employment data used for Table 1 and assessed in Table 9. Government employment includes federal civilian employment, but it has been quite stable.

Economic Development: Porter's book on national competitiveness is available in regular book distribution channels. The version on Massachusetts was produced in collaboration with Monitor Company, Inc. (25 First St., Cambridge, MA 02141). Readers interested in detailed analyses of state incentives will find assessments of how the Midwestern states dealt with Japanese auto plant investments in Ernest Yanarella and William Green, eds, The Politics Of Industrial Recruitment (Greenwood Press, 1990).

Index Of Economic Momentum: The Index is produced by **Reports** every quarter. Each state's most recent one-year growth in personal income, population, and employment is related to the national average growth. The state's advantage (or disadvantage) is averaged for the three measures. Thus, the national score is zero. A state which exceeds national growth in each measure by 1% would have an index of +1. The underlying estimates permit calculations to two decimal points as shown in Tables 1 and 2. There are accuracy problems with each of the three estimates, so small differences among states in percentage change should be taken lightly.

Stadiums: The Heartland Institute (634 S. Wabash, Chicago, IL 60605) has published Should Governments Own Convention Centers? (1991), Sports Stadiums As "Wise Investments": An Evaluation (1990), Is There An Economic Rationale For Subsidizing Sports Stadiums? (1987), and Comparison Of Privately & Publicly Owned Sports Arenas And Stadiums (1985).

Competition And Tax Policy: The 1981 report was published by the Advisory Commission on Intergovernmental Relations, as Interstate Tax Competition.

Medicaid Bootstrap Financing: The June issue of State Legislatures has several important articles on state actions to handle Medicaid and deal with other health care issues. In one, NCSL staffer Tony Hutchison observes: "If historical trends continue, Medicaid costs will keep going up and spending more money will have only a marginal impact on the number of Americans covered. Most of the new money will be consumed by runaway medical costs and federal and judicial mandates that often just rearrange spending without addressing the central problems of the Medicaid program."

Index Prepared by:
HRS Information Research
P. O. Box 20563
Columbus, OH 43220

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* Indicates title of an article

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State financial problems have had many adverse effects. There may be more. States face further risks from national economic circumstances, new federal mandates, rejection of reimbursement claims based on "creative" Medicaid financing, litigation on school finance and federal retiree tax issues, and more.

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Education issues are getting mixed treatment this year as legislators try to find a way to buy additional educational quality without spending much money.

o Education Issues p. 6

More and more states are counting on Medicaid "bootstrap financing" for fiscal salvation. On other health topics, there is practically no action.

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A business magazine tries again to rank the states' management, raising the question of what measures are appropriate.

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State lotteries have arrived, now raising as much as the well-established European lotteries.

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Bridgeport's bankruptcy filing probably isn't a model for others to follow.

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Miscellany deals with associations of state and local officials, governors' opinions, legislative demographics, and tax expenditures. Technical notes indicate data sources.

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July 1991 (First of Two July Issues)

STATE FINANCES AT RISK

Effects Of Fiscal Problems: State decisions this year are demonstrating how much is at stake when the state fiscal outlooks deteriorate.

> **Taxes:** Taxpayers will see tax increases in at least half the states with over 65% of the nation's population. The average worker will pay about $150 more in state taxes because of state legislative action this year.
>
> Actions to deal with state fiscal problems are also causing local tax increases. The effect is direct when states raise the minimum tax requirement in school foundation programs and use devices like Minnesota's mandatory optional local sales tax. Cuts in state aid will also produce incalculable, but substantial, local tax increases as local officials and voters opt to compensate for lower aid by higher taxes as well as by lower spending.
>
> **Public Schools:** Those interested in schools have watched new funding and reforms pass and then not be funded in Mississippi and be funded at a lower level than promised in many states. They have witnessed new reform proposals stall for lack of resources in states like Tennessee. In New Jersey, they have seen state action to take back some of the money previously set aside for education. In many states, state funding for schools hasn't increased to match inflation. In Massachusetts, New York, Rhode Island, and elsewhere it has been cut.
>
> **Higher Education:** Those interested in higher education are experiencing continuation-type budgets, presuming little or no expansion of existing programs and lacking new initiatives. The financing for these budgets is coming from tuition increases of nearly 10%. In some states, universities have been subjected to mid-year cutbacks, more than once in states such as Massachusetts and Virginia. In some states, universities are responding by making it tougher to gain admission and restricting the courses available.

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Health: Those interested in health have seen Medicaid gobble up resources while programs oriented toward prevention and mental health share austere conditions with the rest of state government. Those involved with Medicaid have encountered a constant stream of cost-cutting proposals, most of which don't seem to have worked. The cost-cutting that works, at least in the short term, has been cutting provider reimbursements or at least refusing increases, then cutting the value of the payments by delays in making them.

Social Services: Those interested in social services have seen cash assistance payments under AFDC frozen in most states. In California for AFDC and in many states (e.g., Massachusetts, Ohio) for general assistance, there are proposals to reduce eligibility and/or cut payment amounts. Growing caseloads in the context of desires to limit the growth rate in social service spending have put considerable pressure on spending for other forms of social service. Housing programs, programs to get welfare recipients off welfare through training, and child welfare services have been feeling the fiscal pinch.

Local Government: Local officials have seen the impacts of state fiscal problems in many different ways. The most obvious have been cuts in state aid to local governments as in Massachusetts, Minnesota, and Virginia. Also indirect state aid through tax expenditures to relieve burdens of the property tax are under attack in California, Illinois, Minnesota, and elsewhere. Adverse state fiscal conditions have cut off possible new aid that might have been provided by states to deal with city fiscal problems like those of Bridgeport, Chelsea, New York City, and Philadelphia.

State Workers: State employees have been hard hit by promotion freezes, small or no raises, larger required contributions to health insurance, and, in a few states, furloughs and layoffs. They have also been affected by decisions deferring paydays and restricting travel and by the uncertainties that have affected their working environment.

Other: There have been other programmatic impacts of austerity, such as state support of the arts and staffing of state parks. Sometimes decisions made in several contexts have a substantial cumulative overall impact, such as on library systems supported by both direct state operations and state grants.

Causes And Cures: Without doubt, the magnitude of the current state fiscal problems is associated with national economic recession. It hit immediately following the 1990 elections, catching many states with FY 1991 budgets that had been optimistic about revenues and spending and heavy on one-time items to avoid tax increases or major spending cuts before the election.

Besides recession, some states were affected by special situations. One was the systematic imbalance of revenue and spending known as structural deficits which clearly exist in some states like California and Massachusetts. Such deficits arguably exist in other states, but definitely not in all. Another was decisions to expand spending for reasons other than balancing the budget. Examples: the enacted tax increase in Arkansas for education and the failed proposal in Kansas for property tax relief. The third was dealing with school finance reform court decisions, which will be the primary reason for tax action in Texas.

There is disagreement within individual states and nationally about the extent to which states will have to raise taxes or cut back existing programs to deal with the realities of the 1990s. Steven Gold in The State Fiscal Agenda For The 1990s (NCSL, 1990) argues that states will probably have to increase taxes through the decade. Others (including **Reports** editor Hal Hovey) see increasing state taxes as a percentage of personal income as a choice which state officials will be able to make either way. No one really knows. Whether states will have to raise taxes in the 1990s to maintain existing programs depends upon such unpredictable factors as federal mandates and the growth rate of the economy.

Risks In The Next Twelve Months: Regardless of the longer term outlook, the states face some massive risks during FY 1992. There are a few offsetting possibilities for gains, such as a dramatic and quick recovery from recession, but not much possibility for good news appears on the horizon. The potentials for bad news that would place major strains on state finances include: (1) continuing recession, (2) new federal mandates, (3) restrictions on Medicaid bootstrap financing, (4) school finance litigation and attempts to forestal it, and (5) refunds of taxes paid by federal retirees.

This list doesn't include the serious financial contingencies affecting only one or two states. Past examples include Rhode Island's bailout of financial institutions, California's response to earthquake, and South Carolina's reaction to Hurricane Hugo. That such contingencies will appear in some states is predicable, though what contingencies will appear in which states isn't. In addition, there are future fiscal problems built into some past decisions, such as replacing property taxes in Oregon as required by citizen initiative and dealing with property taxes in Nebraska as required by past court decisions.

More Recession: The conventional economic wisdom being used in state forecasts is typified by the DRI estimates used in the June forecasts of the Illinois Economic and Fiscal Commission. They reflect real GNP growth of 2.1% in FY 1992 (July 1991 through June 1992) versus the negligible growth of 0.1% in FY 1991. On a calendar year basis, the GNP growth in the California Commission on State Finance forecast is 3.0% for 1992, a major improvement over -0.1% in 1991 and 1.0% in 1990. The group's pessimistic alternative to these forecasts assumes a delay of one quarter in recovery, which would drop state revenues by $1.5 billion.

New Federal Mandates: Strenuous state and local objections to mandates and the obvious financial distress in the state and local sector may be encouraging restraint in new federal mandates, though this remains to be seen. The National Conference of State Legislatures is continuing to maintain a list of pending mandate proposals. The list is growing as Members of Congress increasingly recognize that last year's federal budget agreement essentially precludes using grants to influence state and local decisions. This leaves them with the choice of doing nothing on subjects they consider important or introducing legislation backing mandates.

Restrictions On Medicaid Bootstrap Financing: As discussed elsewhere in this issue, many states have seized upon health care provider donations and earmarked taxes as a major portion of the solution for balancing FY 1992 budgets. Massachusetts has used a nationally publicized recovery of nearly $500 million to balance its FY 1991 budget. As a result, FY 1992 bootstrap financing claims could easily amount to $6-8 billion. ***There is a good chance that federal officials will challenge many of these claims,*** particularly after the Congressional moratorium on disallowance expires in December. Disallowance is a double risk. States would lose the revenues they had counted on in FY 1992 and be stuck with the expenditure patterns without the revenue in FY 1993. Some states, such as Indiana, have made their provider reimbursement obligations contingent on the federal allowance, but not all have done so.

School Finance Litigation: As discussed in this issue, school finance cases are active in many states, including New Jersey where officials encountered considerable criticism for their tax increases to fix the problem. In the states facing litigation, elected officials have been reluctant to take state aid away from some districts, thereby triggering the local choice of tax increases or program cuts. Absent action to take from the richer districts to fund more aid to poorer ones, the amounts required to achieve equalization don't fit within current state revenues, even when times are good. Kentucky's tax increases provide an example of what can happen, with Texas soon to debate following this pattern.

Refunds Of Federal Retiree Taxes: The issues associated with past tax payments declared illegally discriminatory against federal employees and retirees in the Davis case are still in litigation. Resolution could bring bad news for the states involved, which have been accruing interest bills on top of the claims. Missouri, which acted immediately to make refunds, needed a temporary tax increase just for this purpose.

Deferred Problems: Many of the budget-balancing resolutions this year have put problems into the future. They include borrowing from other funds or from the public, sale of assets which have to be leased back, deferral of maintenance and equipment purchases, acceleration of revenues, the future costs of early retirement plans, and more. Some of these are classic "one-time" items as they are traditionally called in New York. The spending pattern continues the following year, but the one-time financing doesn't. So financing the spending requires tax increases, sharp cuts in other programs, or another round of one-time items. The supply of these isn't inexhaustible.

Conclusion: All the factors are in place for continuing difficulties in state finances, and thus for all the programs listed at the beginning of this article. The outcome is critically dependent upon the national economy. But state policy will make some difference, particularly determination to control the factors that have in the past several years caused large overruns of budgets for corrections and Medicaid.

EDUCATION ISSUES

Introduction: With most state officials looking to avoid or minimize tax increases, education funding is taking a beating this year, at least by the standards of the late 1980s. School funding is more generous in the few states with money to spend without raising taxes because they have avoided most recession impacts. Education funding is also rising rapidly in two special circumstances: (1) major increases associated with education funding equalization, and (2) new education quality initiatives and their associated tax increases.

School Funding Levels: There continue to be large disparities among the states in school spending. The latest estimates of per pupil spending from the National Education Association appear in Table 1.

The disparities among states are large by just about any measure. The highest state (New York) spends over three times as much per pupil as the lowest state (Utah). Three states exceed the national average by more than 50%. Four states would have to increase their spending by more than 50% to reach the national average.

Teacher Salaries: One of the key factors leading to differences in per pupil costs is teacher salaries. So, it is not surprising that the leaders in spending tend to lead in salaries as shown in Table 2.

Table 1: Expenditures Per Pupil In Attendance, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	New York	$8,680	18	Michigan	$5,257	34	New Mexico	$4,446
2	Connecticut	8,455	19	Wyoming	5,255	35	Indiana	4,398
3	New Jersey	8,451		**United States**	**5,208**	36	Kentucky	4,390
4	Rhode Island	6,989	20	Illinois	5,062	37	Texas	4,326
5	Alaska	6,952	21	Kansas	5,044	38	Arizona	4,196
6	Pennsylvania	6,534	22	Washington	5,042	39	Nebraska	4,080
7	Massachusetts	6,351	23	Hawaii	5,008	40	Louisiana	4,041
8	Maryland	6,184	24	Florida	5,003	41	South Carolina	3,843
9	Delaware	6,016	25	Iowa	4,877	42	Oklahoma	3,835
10	Wisconsin	5,946	26	Georgia	4,852	43	South Dakota	3,730
11	Maine	5,894	27	California	4,826	44	Tennessee	3,707
12	Vermont	5,740	28	Montana	4,794	45	North Dakota	3,685
13	New Hampshire	5,474	29	Colorado	4,702	46	Alabama	3,648
14	Minnesota	5,360	30	West Virginia	4,695	47	Arkansas	3,419
15	Virginia	5,335	31	Nevada	4,677	48	Mississippi	3,322
16	Oregon	5,291	32	North Carolina	4,635	49	Idaho	3,211
17	Ohio	5,269	33	Missouri	4,479	50	Utah	2,767

Table 2: Average Classroom Teacher Salary, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$43,861	17	Hawaii	$32,541	34	Texas	$28,321
2	Connecticut	43,847	18	Virginia	32,382	35	Tennessee	28,248
3	New York	41,600	19	Nevada	32,209	36	South Carolina	28,174
4	California	39,598	20	Oregon	32,200	37	Iowa	27,949
5	Maryland	38,806	21	Indiana	32,178	38	Alabama	27,300
6	New Jersey	38,790	22	Colorado	32,020	39	Nebraska	26,592
7	Michigan	37,682	23	New Hampshire	31,329	40	Louisiana	26,240
8	Rhode Island	37,674	24	Vermont	30,986	41	Montana	26,210
9	Massachusetts	36,090	25	Arizona	30,780	42	New Mexico	26,194
10	Pennsylvania	35,471	26	Florida	30,387	43	West Virginia	25,958
11	Delaware	35,200	27	Kansas	29,923	44	Idaho	25,485
12	Illinois	34,729	28	Kentucky	29,089	45	Utah	25,415
13	Minnesota	33,284	29	North Carolina	29,082	46	Oklahoma	24,649
14	Wisconsin	33,100	30	Wyoming	28,988	47	Mississippi	24,443
	United States	**33,015**	31	Georgia	28,855	48	North Dakota	23,578
15	Washington	32,975	32	Maine	28,700	49	Arkansas	23,040
16	Ohio	32,615	33	Missouri	28,607	50	South Dakota	22,363

Teacher salaries and spending per pupil are roughly correlated with per capita income (with interesting exceptions noted below). They tend to be lowest in the states with the greatest inherent problems in financing schools: (1) a large number of children to educate in relation to population, (2) a growing student population, and (3) relatively low fiscal capacity. States like Utah, Arkansas, and Mississippi fit this definition neatly. The ideal position for high per pupil spending and high salaries is found in the Northeast with a small number of children relative to total population, shrinking enrollment, and high fiscal capacity as measured by per capita income and other indicators. New York, New Jersey, and the New England states are examples.

Class Size: Average class sizes (States In Profile, Table G-17) follow predictable patterns, but have some notable exceptions. States with relatively low tax base per pupil -- that is low per capita income and a high ratio of school age students to population -- have the most strain in meeting national averages. So it is not surprising to find states like Utah (#1), Idaho (#4), and Alabama (#9) with larger-than-average class sizes. Likewise, states with high per capita income and a small percentage of school age children have low class sizes. Examples: Connecticut (#49), New Jersey (#47), and Massachusetts (#46). However, California has the second highest pupil-teacher ratio (22.7-1) in the nation, well above the national average (17.4-1). West Virginia, despite low per capita income, manages to maintain a 15.1 ratio, well below the national average.

Changes In Salaries: Many state elected officials have commitments to attempt to raise teacher salaries. Such commitments are particularly common in the South where salaries are low relative to national averages and state decisions set basic salary schedules. In the North, the salary decision is typically decentralized, though many states set minimum salaries and influence salaries in the ways in which they provide school aid. In any given year, history would lead to the expectation that salaries of teachers, other state and local employees, and private sector employees would rise slightly in excess of the inflation rate. For FY 1991 salaries, this would suggest an inflation rate of 4-5% (depending on whether one looks backward at past inflation or at predicted future inflation) plus an increment reflecting real personal income growth, of about 1%. The national average of a 5.4% increase for teacher salaries thus isn't surprising.

Not all states came close to this average as shown in Table 3.

Because the salary decision is decentralized, there often isn't a simple state policy explanation for differences among states in teacher salary gains. But state factors explain the extremely large and small gains. Top-ranked West Virginia had a statewide teacher strike, followed by a special session of the legislature that raised taxes specifically to fund increases. Kentucky and New Jersey both had major tax increases with improved state funding of local education a major rationale. Northern New England states were making their state and local decisions in the spring of 1990 before recession hit and when money was rolling in from statewide prosperity and rising property values. At the bottom, Mississippi made its teacher salary money dependent upon passage of a state tax plan that did not pass.

Table 3: Percentage Gain In Average Teacher Salary, FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	West Virginia	13.6%	18	Indiana	5.9%	34	New Mexico	4.3%
2	Kentucky	10.6	19	Delaware	5.5	35	California	4.2
3	New Jersey	8.7	20	Florida	5.5	36	Nebraska	4.2
4	Connecticut	8.4		**United States**	**5.4**	37	Colorado	4.1
5	Washington	8.3	21	Nevada	5.3	38	Kansas	4.1
6	New Hampshire	8.1	22	Missouri	5.1	39	Massachusetts	4.0
7	Louisiana	8.0	23	South Dakota	5.0	40	Wisconsin	3.7
8	Alabama	7.9	24	Arizona	4.7	41	South Carolina	3.5
9	Vermont	7.6	25	Michigan	4.6	42	Minnesota	3.4
10	Utah	7.3	26	Virginia	4.6	43	Arkansas	3.1
11	New York	6.9	27	Rhode Island	4.5	44	Georgia	3.0
12	Maine	6.8	28	Ohio	4.5	45	Texas	3.0
13	Idaho	6.8	29	Iowa	4.5	46	Wyoming	2.8
14	Oklahoma	6.8	30	Montana	4.5	47	North Dakota	2.4
15	Pennsylvania	6.4	31	Oregon	4.4	48	Alaska	1.6
16	Maryland	6.0	32	Tennessee	4.4	49	Hawaii	1.5
17	Illinois	5.9	33	North Carolina	4.3	50	Mississippi	0.3

New Assessment Of Student Achievement: The National Assessment of Education Progress recently released comparisons of math test scores of eighth graders in the 37 states that agreed to participate in national testing. The results are shown in Table 4.

Table 4: Average Eighth Grade Scores In Math, 1990

Rank	State	Score	Rank	State	Score	Rank	State	Score
1	North Dakota	281	18	Virginia	264	34	Alabama	252
2	Montana	280	19	Oklahoma	263	35	Hawaii	251
3	Iowa	278	20	Delaware	261	36	North Carolina	250
4	Minnesota	276		**United States**	**261**	37	Louisiana	246
5	Nebraska	276	21	New York	261		Alaska	
6	Wisconsin	274	22	Illinois	260		Kansas	
7	New Hampshire	273	23	Maryland	260		Maine	
8	Idaho	272	24	Rhode Island	260		Massachusetts	
9	Wyoming	272	25	Arizona	259		Mississippi	
10	Oregon	271	26	Georgia	258		Missouri	
11	Connecticut	270	27	Texas	258		Nevada	
12	New Jersey	269	28	Arkansas	256		South Carolina	
13	Colorado	267	29	California	256		South Dakota	
14	Indiana	267	30	Kentucky	256		Tennessee	
15	Pennsylvania	266	31	New Mexico	256		Utah	
16	Michigan	264	32	West Virginia	256		Vermont	
17	Ohio	264	33	Florida	255		Washington	

Education Secretary Lamar Alexander called the survey "an alarm bell that ought to ring all night." By his standards, "none of the states are cutting it." By one standard, only one seventh of the eighth graders tested did as well as should be expected. The states that did best, the Upper Midwest, rank high on most education indicators. There are demographic explanations associated with this outcome, such as a large percentage of rural population and a smaller percentage in poverty, but there are other explanations. For example, students of teachers majoring in math did better than those whose instructors majored in education.

Public Opinion on School Reform And Finance: A combined effort of Southern Opinion Research and the Birmingham News (4/14) yielded interesting contrasts between attitudes of legislators and Alabama citizens on school issues. Residents and legislators favored some school reform measures by large and similar margins. Examples: competence exams for teachers, making it easier to fire teachers, expanding preschool programs, increasing state funding of schools, and increasing required math and science courses. But they differed in other views as shown in Table 5.

Table 5: Views of Alabama Residents and Legislators, 1991

Proposition	Percent Agreeing Residents	Percent Agreeing Legislators
Give more state money to poor districts than wealthy ones	83%	59%
Allow parents to choose which school children will attend	76	50
Raise the salaries of school teachers	68	83
Increase the length of the school year	24	63
Major problem in schools is not using money wisely	54	17

Alabama school finance is unique because a substantial share of state revenues is earmarked for support of education. Local support is low, 49th in the nation. It is discouraged by a prohibition against local school officials asking voters for additional money. An act of the legislature is required for the question of raising school taxes to be put to voters. Letting boards of education take proposed tax increases to voters was supported by more than 70% of residents and legislators. But letting local boards levy additional taxes without a public vote was supported by only a quarter of each. Various tax studies have suggested more use of property taxes for Alabama school finance. This was reflected by a 54% preference for property taxes (with 31% no opinion or no answer) from legislators asked which tax should be used if school funding were increased. Given the option of raising taxes on beer and cigarettes, 55% of residents picked sin taxes with property taxes drawing 19%, sales taxes getting 14%, and income taxes only 6%.

School Finance Equalization: "We're not going to let some court tell us how to fund our schools in Ohio, and we're going to do something about it," Ohio's Governor Voinovich promised an Akron audience shortly after his inauguration. In separate actions, Cleveland and a group of poor districts in the Appalachian portion of the state are preparing to litigate. The poor districts seek a classic equalization decision, like the Texas one. Cleveland, which isn't poor in tax base per pupil, seeks a more elaborate decision reflecting special problems of urban areas, like the New Jersey decision.

A select committee of the Ohio legislature has looked at equalization alternatives and arrived at mostly conventional recommendations. But it added a tax base sharing proposal that 50% of new business tax base be pooled in Cuyahoga County, which contains Cleveland and many smaller communities of varying wealth. The governor has endorsed pooling, which was a major feature of the Texas plan adopted this year. This is a difficult year for Ohio to try to reform its formula. The governor's determination to avoid tax hikes and pressures in other parts of the budget mean essentially no money for equalization plans, with school aid likely to rise less than 4% a year over the next two years. This leaves a choice of taking from the rich to give to the poor or doing nothing.

The Education Commission of the States recently published a readable 64-page review of Education Finance In the 1990s. Essays by Steven Gold (State University of New York), education formula consultant John Augenblick, and Kent McGuire (U. of Colorado) review topics like state versus local funding, school finance litigation, and the links between school quality initiatives and school aid formulas. The pamphlet includes tables detailing the status of school finance litigation in each state.

The economic case for school finance equalization is stronger in New Hampshire than elsewhere. The state divides its pupils and tax base into large numbers of small districts, with resulting large disparities in tax base per pupil. It eschews any major state aid program, with the current program confined to what the lottery will raise. This means the state program, though equalizing, can have little effect in offsetting major disparities.

A group of poorer districts began their litigation in June. The average district in New Hampshire has a tax base of $451,939 per pupil and an average tax rate of 0.92%, resulting in tax of just over $4,000 per pupil. The poorest district has a base of $106,950 per pupil while the richest has $17 million. If each levied the average tax, the poorest would raise $984 and the richest over $150,000. The issue is not whether these are large differences, but whether such differences violate the requirements of the New Hampshire constitution.

Special Education: Special education costs seem to be getting increasing attention from state and local officials. Federal programs provided impetus for extra funding and special treatment for a group of youth broadly defined as those with handicaps, mental or physical. This resulted in the intended consequence of extra programs (and cost) for these youth and an unintended consequence. School administrators and teachers could provide smaller classes and more materials for students if they defined them as needing special education. So the number of students so classified has tended to grow. In New York City, 22% of public school children are in this classification. An effort is being made to shift those not really needing the program back into regular classrooms. Comparative statistics among states or cities are indicative of how local practice affects results. For example, 83% of special education students in New York City are learning disabled and emotionally disturbed, a percentage well in excess of other large cities, particularly Atlanta with 38%.

Special education budgets are an example of diffused accountability in the federal system. Often there is an incentive at the school district, school, and classroom level to classify more and more children as special education children. Doing so triggers state and federal assistance not available if the children aren't so classified. But the classification also triggers a variety of rights under federal and often state law. So from the local level, the programs can appear exempt from budgetary scrutiny. For example, in examining New York's situation, the New York Times (4/30) reported, "Special education is protected against reductions by a web of state mandates and court rulings." Whether this statement is legally true isn't the only issue. If New York school officials believe it to be true and are not challenged by others, it is operationally true.

Rights to special education can have implications beyond special education students. The Richmond (CA) case (discussed last issue) was decided on the basis of one suit, but another was pending that also could have mandated the state to keep the schools open. It was brought on behalf of special education students, with the argument being that the state had a duty to keep schools open for them.

In Massachusetts, the state is responsible for substantial local costs because it requires local schools to provide special needs students with the "maximum feasible benefit." Governor Weld estimates that moving from this standard to the federal minimum standard would save local governments $54 million a year. In the legislature, the approach being offered is to keep the standard of care, but reduce the number of students identified for special education -- about 17% of all students compared to a national average of about 12%. In Pennsylvania, Governor Casey's budget proposals are designed to control what he has called "the runaway costs" of special education.

Similar actions are predicable in many states. Federal aid now defrays less than 10% of special education costs. No one believes that the 40% suggested by the original federal legislation will ever be reached. This puts considerable pressure on the states, particularly when state mandates seem to be driving local costs. In times of state fiscal stress, the tendency is to examine both the mandates and the costs.

Education Choice: Not much appears to be happening with the idea of student choice, though there is considerable activity in articles written, speeches given, and bills introduced. The President's education proposal, with $230 million for experiments in choice, is pending in the Congress with prospects uncertain.

The small New Hampshire community of Epsom attracted national attention when town selectmen adopted a policy of abating property taxes by $1,000 for those who send a pupil to private school rather than the town school. Selectmen argued they would save $3,000-4,000 per transfer. They got national publicity and litigation. The tax abatement approach follows the precedent of the Minnesota tuition tax credit, but involves substantially more money. An outright grant plan was introduced in the Pennsylvania legislature this year and probably in many others. Two Kansas legislators introduced legislation for Wichita modeled upon the Milwaukee plan. Massachusetts legislators passed a choice plan earlier this year, but work on the budget has overwhelmed work on implementing regulations.

For those looking for plans with a track record, there isn't much to go on except limited experience in Minnesota with choice among public schools. The litigation over choice plans is in various intermediate stages, providing little guidance on outcomes for plans adopted in other states.

HEALTH CARE

Introduction: Health care, other than financing Medicaid, hasn't been a major topic in the legislative sessions this year. There has been essentially no movement on state versions of universal care. The Massachusetts plan adopted in 1988 continues to have implementation postponed. The governor wants to take the law off the books, but legislators have been shifting the date, keeping it about two years away from the current year. Minnesota legislators adopted a demonstration program this year with an extra increase in the cigarette tax to fund it. The governor vetoed the tax and the plan on the grounds of incalculable future costs.

Medicaid Bootstrap Financing: One thing going for Pennsylvania in the Financial World rankings described in this issue is its "miraculous new Medicaid funding plan." The magazine explains:

> Donations from hospitals are used to apply for matching federal dollars. Then, money is cycled back to

hospitals. No one loses except feds, budget director reports gleefully.

While the Pennsylvania write-up used "miraculous," the term used to describe Massachusetts' plan suggested magic. The story ran in many major newspapers, generally based on a front page New York Times (6/8) story combining human interest and state fiscal reporting. It began:

> After months of struggling to close Massachusetts's yawning budget deficit, Governor William F. Weld announced this week that the problem has been almost magically solved. Not by the state's 200 legislators. Not by his budget planners. But by a part time state employee who earns $22,000 a year.

The accomplishment is getting the federal government to kick in $489 million in dealing with the Massachusetts deficit for FY 1991 of about the same amount. The federal contribution is $81 per capita, making the total federal tab $20.2 billion if comparable payments were made to all states. Richard Nathan (State University of New York at Albany) commented, "This has become a new kind of big game hunt for state budget entrepreneurs." Forbes (7/8) talks of "a brand new pork barrel." It quotes the inspector general of the federal Department of Health and Human Services calling the growth of provider taxes and donation programs "like a virus spreading from state to state."

In Pennsylvania, the deal for nursing homes is being put together by the county commissioners' association (which gets a fee) because many counties are home operators. A hitch developed in late June when officials of two counties expressed reservations about participating, fearing that the federal government would later seek recovery. The Pennsylvania plan doesn't require cash provider donations, instead the money is being borrowed on behalf of the counties.

The count of states with operational bootstrap financing programs is now at least 25. In the new fiscal year, many more will be added. For example, Indiana has just adopted a program and Alabama has passed a new program with comprehensive taxes on Medicaid providers including hospitals, nursing homes, and pharmacies.

New Jersey Health Financing: "This is goring everybody's ox." That was the Speaker's summary of the legislation that barely passed the New Jersey Senate and was pending in the House in mid-June as proponents looked for enough votes to pass it. Opponents include the state Chamber of Commerce and the AFL-CIO. Proponents include the hospital association and the New Jersey Business and Industry Association.

Labor and management (excluding small business) appeared to have reached agreement last year on a comprehensive plan including a tax of over $1,000 per employee-year on firms not providing health insurance and over $100 per employee year on other firms. The plan floundered on opposition to the taxes and the state's inability to finance the added state spending on Medicaid vital to the plan's success. But legislators refused to renew the uncompensated care fund, which involved a tax of about 20% on hospital bills. Since January, individual hospitals have had their own uncompensated care surcharges, some as high as 50%. This provided an obvious inducement for consumers to use the lower surcharge hospitals. Clearly, some action was needed. The current 62-page bill is designed to reconstitute the fund with a new name and make other changes in the health care system.

The New Jersey fund bore some resemblance to the Massachusetts financing device used to recover nearly $500 million in bootstrap financing money from Medicaid. As of mid-June, the governor's lead person on health care financing wasn't making any commitments about future revenue from that source for New Jersey:

> We don't know if we are going to get the money. We don't know how much it is. We don't know what the needs are going to be so we are not making any comments or commitments or even discussions on what you do with money that you don't have.

Medicaid As An Upper Middle Class Benefit: Respectable publications continue to publish advice on how affluent people can protect their assets and get Medicaid. The example in the Wall Street Journal is a person with a home and $150,000 in liquid assets. The bottom line is that Medicaid (and the earnings on the assets) pay for nursing home care, but the heirs get the $150,000 free of any government attachment. The plan works even better for married persons.

STATE MANAGEMENT

Introduction: Last year Financial World presented a ranking of states based on their financial management. **Reports** was critical of the rankings on the grounds that neither the criteria nor the data on which they were based were spelled out. **Reports** and officials of some low-ranked states criticized some specific state results as being implausible. This year, with some changes in criteria, the magazine tried again in its May 28 issue.

The Rankings: Fourteen areas were examined in deriving the rankings, but with no indication of what weight was given each, whether the weighting varied from state to state, and no presentation of the numbers used and where they came from. As a result, the value and meaning of the outcomes are in doubt. It's like being called the best team in baseball without knowing whether the criterion was most games won, most hits, or best dressed. Winning such an award feels good, or at least better than losing it. In 1990, Governor Casey (PA) featured a favorable rating in TV spots in his successful reelection campaign. Winners can crow and the management of the losers will be criticized, but the World Series of state management the FW rankings are not.

This being said, the ratings do seem to have achieved the status of "reputational rankings," such as those used to assess universities for potential students. Such rankings can be said to have validity if they arrive at results similar to what other experts would produce if confronted with the same questions. The rankings appear in Table 6.

Table 6: Financial World Rankings Of State Management, 1991
Ranks Plus Standard & Poor's Bond Ratings

Rank	State	Rating	Rank	State	Rating	Rank	State	Rating
1	Utah	AAA	18	Georgia	AA+	35	Wyoming	*
2	Missouri	AAA	19	New Hampshire	AA+	36	Illinois	AA+
3	Maryland	AAA	20	New Jersey	AAA	37	Kentucky	AA
4	Virginia	AAA	21	Pennsylvania	AA-	38	Idaho	*
5	South Carolina	AAA	22	Alabama	AA	39	Oklahoma	AA
6	Tennessee	AA+	23	Mississippi	AA-	40	Kansas	*
7	Washington	AA	24	Louisiana	A	41	California	AAA
8	North Carolina	AAA	25	Colorado	*	42	North Dakota	AA
9	Minnesota	AA+	26	Michigan	AA	43	New York	A
10	Wisconsin	AA	27	Texas	AA	44	Rhode Island	AA
11	Indiana	*	28	Ohio	AA	45	New Mexico	AA
12	Iowa	*	29	Arizona	*	46	Connecticut	AA
13	Nevada	AA	30	Montana	AA-	47	West Virginia	A+
14	Florida	AA	31	Nebraska	*	48	Maine	AAA
15	Hawaii	AA	32	South Dakota	*	49	Vermont	AA
16	Delaware	AA+	33	Alaska	AA-	50	Massachusetts	BBB
17	Oregon	AA-	34	Arkansas	AA			

* No general obligation debt, thus no rating.

What Is Being Measured? Financial World doesn't indicate unambiguously what the rankings measure. Its cover lists the "10 best" and "10 worst." which could mean best place to retire, best place to start a business, or best state-supported child care system. The magazine's editor suggests state management is the criterion. The article mentions "good management skills coupled with efficient operations" and states "doing a particularly good or bad job" A short summary of how the rankings were derived discusses how well states "manage the resources available to them" and "the skill and efficiency with which states are run."

The criteria emphasize financial management, resembling some of the criteria for bond ratings, which themselves are one of the 14 criteria. States are well managed if their recent budgets show surpluses, large balances and rainy day funds are maintained, Medicaid payments aren't backlogged, and large unfunded pension obligations are avoided. Half the criteria involve processes to achieve these results by projecting revenues over a long period, accurately estimating revenue and spending, completing budget decisions on time, evaluating agency performance, having management controls for infrastructure, and maintaining award-winning accounting and auditing systems.

Rankings And Bond Ratings: As Table 6 suggests, there is a correlation between the FW rankings and S&P ratings. The worst state bond ranking belongs to Massachusetts, which gets last place from FW. Next lowest bond rankings are New York (#43 for FW), Louisiana (#24), and West Virginia (#47). The "AAA" states all rank in the top ten except three with current fiscal problems that affected their FW rating and may well affect their bond rating -- New Jersey (#20), California (#41), and Maine (#48). Maine subsequently was downgraded to AA+. On California, "Hard to feel sympathy for Californians. They created Frankenstein monster, then complain when he eats too much."

Rankings And Financial Management: Without explicit criteria, it is hard to say whether ratings are right or not. There are some anomalies. Being a high spending state hurts Vermont (#49), which is criticized for its welfare payment level, as well as other low ranked states. Most of the top ten are low spending states, but Maryland, Minnesota, and Wisconsin are in the group. Sometimes process overwhelms substance. Florida (#14) gets credit for projecting revenue to 2001 while Idaho and Nevada are faulted for not doing so. In practice, Florida revenues always fall short of spending plans which often isn't true in Idaho and Nevada. Maybe tough, conservative fiscal practices that prevent inadvertent tax increases because of overspending, overly optimistic revenue estimates, or pushing spending into future years should be the test. Many of FW's winners would make this list -- Utah (#1), Missouri (#2), Indiana (#11) -- as would some also-rans -- Nebraska (#31), Arkansas (#34), Oklahoma (#39), and North Dakota (#42).

How sophisticated a state's financial reporting, budget processes, and revenue estimating are doesn't necessarily correlate with financial management measured by avoiding debt, keeping reserves, or keeping low taxes. The award for sophisticated processes and staff work would go to the federal government. Processes in some states (e.g., California, New York, and Wisconsin) are sophisticated in this sense, but in functional terms others (e.g., Arkansas, Idaho, North Dakota) seem to get the job done.

LOTTERIES

State lotteries are now mature institutions. New Hampshire and New York have had them for over two decades. Other large state lotteries were generally established in the mid- to late-1980s, long enough ago so that their results can be compared without worrying about whether they are still gaining consumer acceptance. Table 7 does this, along with some lotteries from other developed nations.

Table 7: Total Lottery Sales Per Capita, 1990

Rank	State/Country	Sales	Rank	State/Country	Sales	Rank	State/Country	Sales
1	Massachusetts	$265.88		N.S.W. Australia	$78.64		Gr. Britain	$24.38
2	Maryland	171.59	16	Virginia	77.08	32	Minnesota	15.69
3	Connecticut	160.15	17	Arizona	76.77		Alabama	0
4	Florida	158.47	18	Vermont	76.61		Alaska	0
5	New Jersey	154.85	19	Indiana	72.63		Arkansas	0
	Quebec, Can.	154.50	20	Rhode Island	65.80		Georgia	0
6	Ohio	149.56	21	Idaho	65.35		Hawaii	0
7	Illinois	131.14	22	Wisconsin	63.72		Louisiana	0
8	Pennsylvania	130.46	23	Iowa	60.98		Mississippi	0
9	Michigan	128.93	24	Oregon	58.27		Nebraska	0
	Ontario, Can.	125.90		France	57.51		Nevada	0
10	New York	115.82	25	Kentucky	52.86		New Mexico	0
11	Delaware	99.10	26	Washington	52.85		North Carolina	0
12	South Dakota	91.69		Italy	46.48		North Dakota	0
	Germany	87.19	27	Missouri	43.04		Oklahoma	0
13	New Hampshire	85.79	28	Colorado	40.79		South Carolina	0
14	California	85.02	29	West Virginia	36.13		Tennessee	0
	Belgium	81.28	30	Montana	26.88		Texas	0
15	Maine	79.26	31	Kansas	25.90		Utah	0
	Ireland	79.12					Wyoming	0

Lotteries were an issue in some states this year, but not many. The lotteries are so well established in most larger states that the major issues associated with them were how to use proceeds. The tendency has been to convert lottery proceeds from an extra resource to part of the baseline resources for the regular state budget. This happened in New Hampshire several years ago with similar patterns now being followed in Ohio, Virginia, and probably other states. In states with lotteries, legislators are constantly asking why the yield can't be made higher and sometimes making proposals, like sports betting, for raising consumer interest and thus state revenues.

Establishing a lottery was an issue in some states. The plan appeared to have a reasonably good chance in Texas where the need for added state revenues was clear and the governor backed it. But it was defeated early in the legislative session. The decision could be reassessed when the legislature meets later this year to consider financial matters. Georgia's legislature approved a lottery proposal for submission to voters.

Table 7 suggests that the state lotteries in the United States have caught on with the public about as well as the major European and Canadian lotteries. It also shows major deviations among states in the success of state lotteries. There are many possible explanations for these differences, none totally convincing.

Several major professional sports leagues are pushing federal legislation to preempt state authority to legalize gambling on sports events through state lotteries. Citing state fiscal problems, Kansas State Representative Wanda Fuller testified for the National Conference of State Legislatures that Congress shouldn't restrict state revenue-raising options.

THE BANKRUPTCY SOLUTION

Fiscal Adversity And Its Remedies: Every year some of the 80,000 American local governments suffer serious adversity. Mines close in mining towns. Factories close in one-plant communities. Major uninsured losses occur. Treasurers make bad investments or abscond with money. Less serious adversity arises when the expectations of local officials for what they should spend don't conform with what taxpayers are willing to provide. The usual result, generally required by state law, is to adjust spending to conform with revenue. Occasionally, local officials will spend what they think is necessary and then close down when they run out of money. There are differing state procedures to deal with such situations, often involving some sort of receivership similar to what international labor unions use with their locals.

Recent Bankruptcy Filings: The Richmond (CA) school district got national publicity by a bankruptcy filing that is now being resolved by other means (Issue 12). In June, the City of Bridgeport filed for bankruptcy. Connecticut's attorney general is contesting the filing on the grounds that the city has no authority under state law to make such a filing. Bridgeport is already subject to state oversight through the state's Bridgeport Financial Review Board which resembles state oversight agencies used for Cleveland, New York City, Yonkers, and other jurisdictions. Whether the state or the city prevails depends upon interpretation of Connecticut state law on the powers of municipalities. Even if Connecticut prevails in the Bridgeport case, it is entirely possible that a municipality or county from another state could go the bankruptcy route.

What Will Bankruptcy Do? In broad terms the choices facing the Bridgeport council in its new budget were: (1) raise real property taxes 15-20%, (2) obtain apparently unobtainable concessions on compensation from city workers under circumstances where binding arbitration causes the bargaining environment to differ from most other communities, or (3) make major additional layoffs including garbage collectors and police officers. The bankruptcy filing was seen by many observers as an attempt to win labor concessions in order to avoid the other alternatives. In a bargaining environment of a bankruptcy, this could actually happen. In fact, some labor leaders said the mayor had unilaterally broken off negotiations that could have been fruitful. Bridgeport officials are explicit that they are not seeking to abrogate payment obligations to vendors or bondholders.

Viewed as an aid to labor negotiations, not many state or local officials are likely to pursue the bankruptcy route. It has substantial costs in diminished reputation of the jurisdiction (and thus economic development potential and citizen satisfaction), higher interest costs for borrowing, legal costs for the bankruptcy proceeding itself, and loss of control over the negotiating process. Whether there is a political cost to the elected officials involved remains to be seen.

How Does Bankruptcy Work? The classic bankruptcy case terminates the debtor (corporations) or gives the debtor a clean start (individuals) free of debt. The court allocates the remaining resources among the creditors. There are special bankruptcy procedures for corporations (Chapter 11 of the bankruptcy code) and governments (Chapter 9) where the intent is to retain the petitioner as a going concern.

In Chapter 11, the courts exercise extraordinary power on the grounds that they must do so to protect creditors who have a better chance of getting paid by a going concern than by one that simply folds. So airline creditors entitled to repossess airplanes are told they can't do so because the airline needs them to have a chance to pay off all debtors. Department store creditors entitled to a first lien on merchandise are told they can't seize merchandise delivered after the bankruptcy filing. Some of these principles may apply in the case of small municipal utility districts serving new housing developments, which is where much of the Chapter 9 experience has come.

It isn't obvious how these principles would apply in the case of a major municipality or state. There is considerable doubt among legal experts as to what rules would apply (e.g., "What's Next In Bridgeport's Bankruptcy," Wall Street Journal, 6/14).

Broader Implications: Shortly after the bankruptcy filing, Bridgeport's mayor joined the mayor of Minneapolis as he presented concerns over central cities to a Congressional committee. They raised the broad concerns over central city finance often addressed in **Reports** and by a wide variety of state actions.

Those concerns are particularly salient in the Northeast at the moment because of the convergence of several factors. First, recession has hit the Northeast hardest with adverse effects on city residents, city tax bases, state aid, and state ability to provide emergency assistance. Second, Northeastern cities and towns are small independent entities with no overlapping county governments. The cities and towns are responsible for social and health service costs which counties handle in other states. The independence and small size of these New England jurisdictions mean that more affluent taxpayers can, and do, leave behind the problems of communities like Bridgeport, Hartford, and New Haven and their counterparts in other New England states.

State Action: There are state mechanisms specifically designed to deal with distress in individual local communities, including the Connecticut board established to deal with Bridgeport. This year, for example, Massachusetts has provided emergency aid to Chelsea and Rhode Island is taking over the school system in Central Falls. Actions like these have a general statutory base in Pennsylvania, see "Locals In Distress: What Can States Do?" by Ron Snell and Scott Mackey in NCSL's Fiscal Letter (May/June).

MISCELLANY

Associations Of State And Local Officials: Many of the major associations of state and local officials -- like the National Governors' Association, the National Conference of State Legislatures, the National League of Cities, the National Association of Counties, and the U.S. Conference of Mayors -- have a strong federal orientation. With the exception of most of NCSL's operation which is in Denver, they are based in Washington, DC. Substantial parts of their budgets come from federal grants. Large parts of their meetings and policy positions are devoted to federal, not state and local, policy decisions. Much of their staff activity is associated with reporting on federal developments and lobbying for members' preferences for federal policy.

In Governing (June), Jonathan Walters concludes the groups are having to confront the question: "Should Washington remain the center of their universe when the federal government is all but ordering them to solve their own problems with their own money?" He sees the debate as more intense for organizations of local officials than organizations of state officials. Several people prominent in local government affairs are quoted as suggesting the local organizations should focus more on states.

Ellen Perlman takes a broader swipe in City & State (6/3):

> Despite lobbying by the associations, state and local jurisdictions have taken a pounding from the federal government in the form of decreases in grants and increases in both the number and cost of mandates.

> Are the associations providing what members want -- and need? Are members getting their money's worth from those who represent them?

But she concludes that membership in the associations is "vital." Much of her extensive discussion of association work concerns the two organizations representing cities and how they do, and don't, work together.

Governors' Opinions: An otherwise standard description of state and local fiscal problems in Newsweek (7/1) has a poll of 46 of the nation's governors "or aides they designated." There were some predictable answers, such as suggesting fewer federal mandates, and some less predictable ones. Asked "What are the most serious unmet needs in your state because of budget problems?" 57% picked health care, followed by social services (43%), higher education (41%), and public works (42%). Lower concern over unmet needs was expressed for secondary education (26%), prisons (24%), housing (20%), and law enforcement (13%). Asked to select governors (other than themselves) most effective in their positions, responders picked governors who have been in office at least a few years and have been active in the National Governors' Association. In order, choices were Clinton (D-AR), Romer (D-CO), Gardner (D-WA), Campbell (R-SC), and Ashcroft (R-MO).

Legislative Demographics: The changing composition of the North Carolina legislature shown in Table 8 shows demographic aspects illustrating national trends and political changes characterizing the formerly solidly Democratic southern legislatures.

Table 8: Percent Of North Carolina Legislators With Selected Characteristics

Characteristic	1971	1991
Democrats	82%	69%
Republicans	18	31
Males	98	85
Females	2	15
Whites	98	87
Blacks	2	13
Lawyers	40	21
Percent Members New To Legislature -- Senate	36	16
Percent Members New To Legislature -- House	36	18
Average Age of House Member	49	57

The increasing percentage of women in legislatures is a nationwide phenomenon documented in the April-June Journal Of State Government, which is totally devoted to women in state politics. Women are under 10% of legislators (1991 data) only in Louisiana (lowest at 2.8%), Kentucky, Alabama, Arkansas, Mississippi, Oklahoma, and Pennsylvania. Over 30% of legislators are women in Arizona (highest at 33.3%), Maine, New Hampshire, Vermont, Washington, and Colorado.

Legislative Staff Cutbacks: In mid-June, the California Supreme Court provided a reprieve to legislative staff members scheduled to be laid off as part of implementation of Proposition 140. The decision is a temporary one, pending final decision by the court on the constitutionality of the proposition. Besides mandating a reduction in legislative staff, it limits the terms of legislators.

Tax Expenditures: About a dozen states prepare periodic reports on "tax expenditures" -- revenue forgone because of exemptions to current state taxes. One of the better examples is the 246-page California report. There are complex definitional issues involved in measuring the revenue loss from tax exemptions. Not the least of these is whether a "tax expenditure" should be viewed as this loss or as the amount of budgeted spending required to produce the same effects.

The study concludes that in FY 1992 tax expenditures cost California state and local governments $24.5 billion, of which $19.9 billion was state loss. The state loss compares to general fund spending of about $43 billion. The loss is greatest for the personal income tax, 67% of the amount collected. Losses were smaller for the corporate income tax (32%), sales tax (25%), and other taxes (6%).

Tax expenditure reports have become a veritable hunting ground for elected officials seeking ways to raise money without increasing tax rates. The governor's proposal in California seeks to end the sales tax exemptions for bottled water, candy, equipment rentals, fuel for boats and planes, magazines, newspapers, and snack foods. Legislators have proposed closing other exemptions.

In most states, conformity with the federal income tax code is valued highly enough to preclude serious consideration of state decisions altering federal income definitions. There are a few exceptions, such as exclusion of Social Security income in many states and differing treatment of capital gains in a few. But these are rare. In California, proposals to alter the income tax base are common. Examples from this year: (1) eliminating deductibility of mortgage interest for second homes, (2) ending the step-up of basis of capital assets transferred at death, (3) limiting the deductibility of entertainment expenses, and (4) limiting carrying forward losses on corporate returns.

Tax Preferences: A recent California poll (Sacramento Bee, 6/11) confirms previous polls on the public's tax preferences. Increasing the sales tax rate by 1.25% and a 2% tax on all utility bills drew more opposition than support. More narrow proposals, with less revenue raising potential, did better. There was slightly more support than opposition for two proposals to broaden the sales tax base, one to cover amusements like movies and sporting events and the other to cover candy, newspapers, and magazines. Raising the top bracket individual income and corporate income tax rate from 9.3% to 10% got 47% support and 26% opposition. Raising the individual rate from 9.3% to 11% for individuals with income over $100,000 ($200,000 for couples) got 70% support and only 17% disapproval.

TECHNICAL NOTES

Education: The math scores are from the U.S. Department of Education, The State Of Mathematics Achievement, reflecting work done under contract by the Educational Testing Service. The authors don't like using rankings for their data, as **Reports** did. The report will be forming the starting point for further state-by-state comparisons, see "Panel Chooses Achievement Measures," Governors' Weekly Bulletin (6/7) for details. The National Governors' Association reports progress of its goals project in the Bulletin and other publications such as State Actions To Restructure Schools and State Strategies For Achieving The National Education Goals. The National Education Association (1201 16th St., N.W., Washington, DC 20036) data appeared in Estimates Of School Statistics: 1990-91. For overviews of school finance see Advisory Commission on Intergovernmental Relations (Washington, DC 20575), The Structure Of State Aid To Elementary And Secondary Education or the less elaborate, more readable NEA summary, What Everyone Should Know About Financing Our Schools.

For a popularized summary of research on the outcomes of choice programs, see New York Times (6/12). There are many studies of choice, but generally these are assessments of arguments for and against rather than assessments of results. See, for example, Abigail Thernstrom, School Choice In Massachusetts (Pioneer Institute, 1105 Commonwealth Ave., Boston, MA 02215, 1991) and William Clune and John Witte, Choice And Control In American Education (Falmer Press, 1990).

Legislative Demographics: The profiles are from a 246-page assessment, Article II: A Guide To The 1991-92 N. C. Legislature (N.C. Center for Public Policy Research, P.O. Box 430, 5 W. Hargett St., Raleigh, NC 27602).

Tax Expenditures: The California report, Analysis Of The 1991-1992 Tax Expenditure Budget, is produced by the Legislative Analyst (925 L St., Sacramento, CA 95814).

Lotteries: The lottery sales compilation appeared as an insert in the May 15 issue of Gambling and Wagering Business.

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Public higher education officials have assessed how the budget pie was divided this year and found they got a smaller piece.

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Rising welfare caseloads have been putting pressures on state budgets. State responses have varied, with new emphasis on general assistance.

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State finances have been in the news, but primarily because of decisions not made on time in a few states rather than the decisions that were made.

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July 1991 (Second of Two July Issues)

RABBITS OUT OF THE HAT

Introduction: The carnage from the 1991 legislative sessions has been substantial from the standpoint of taxpayers, affected by $16-20 billion of new state taxes, and those interested in state spending (see Issue 13). But the impacts aren't as great as they could have been. Why not? Faced with the difficult choice between cutting spending and raising taxes, state officials looked for a way out. To some extent in some states, they found it.

Patterns Of The Northeast And California: The worst fiscal problems were concentrated in the Northeast and California. Many of these states found it necessary to undertake major tax hikes and cuts in spending patterns. Per capita state tax increases in the $100-250 range roughly approximate what happened (or is likely to happen) in California, Connecticut, Maine, Pennsylvania, Rhode Island, and Vermont. In addition, these states have selected half or more of a standard list of austerity measures -- reducing personnel, shifting some costs of employee benefits to employees, freezing local aid, raising university tuition well above the inflation rate, denying salary increases, rejecting welfare payment increases, cutting reimbursements for health care and social service providers, and avoiding new programs.

Budget Magic: Four states seem to have fared better than others similarly situated. The four share demographic characteristics with the others and have experienced the recession to at least the same degree. They have experienced the same shortfalls in revenue. They are subject, in varying degrees, to the same pressures to increase spending as the others, excepting school finance equalization cases. They took some of the same budgetary steps. But in broad overview, they appear to have done better. That is, they have neither increased taxes as much as comparably situated states nor have they been forced into the same magnitude of expenditure cuts. The states are Massachusetts, New Hampshire, New Jersey, and New York.

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New Hampshire has felt the recession about as badly as any other state. Nearly everyone believed the state's avoidance of personal income and general sales taxes would be severely tested. That consensus included the governor, who pledged to veto either measure. The governor and sympathetic legislators worked on alternatives which would tax businesses differently to reach returns of professional businesses (which have no taxable profits). But as the legislature concluded work in late June, there was no new business tax, no personal income tax, and no general sales tax. There were other tax increases -- telephone service, inheritance, the tax on the state's only nuclear plant -- but no broad-based tax was enacted.

New Jersey enacted its massive tax hike in 1990, but committed all the new money for school aid, property tax relief, and aid to hard pressed urban governments. Recession affected the rest of state finances as though there had been no tax increase. All participants agreed that another tax hike was out of the question. The new budget has no tax increase.

New York clearly faced problems. In December, before the magnitude of economic downturn was known, the governor was talking about 10,000 layoffs and critics were arguing the state's use of "one-shot" devices to balance the budget had worked it into a serious hole. Yet New York finished the session, and subsequent renegotiations, with tax increases of under $100 per capita that won't be noticed by most residents. Layoffs are possible, but are unlikely to be massive.

New York City was on the receiving end of some of the state's cuts and has severe fiscal problems even without the cuts. There are double digit increases in city income and real property taxes as well as other tax and fee increases. Substantial layoffs are also being made, perhaps over 10,000.

Massachusetts really pulled a fiscal rabbit out of a hat -- a second Massachusetts miracle. The FY 1991 budget was out of balance by all reckoning when the new governor took office. Early this year, by some estimates, a budget of $13-14 billion for FY 1992 was out of balance by as much as $2 billion. Now the state has a budget said to be balanced in FY 1992 after finishing a balanced FY 1991. Furthermore, the sales tax on services scheduled to go into effect in the spring was repealed and a slight drop in the income tax scheduled for the end of 1991 will now take place on schedule. While other Northeastern states raised taxes substantially, Massachusetts will be one of a couple of states to lower taxes by 1991 legislative action.

How They Did It: These states put together many techniques that avoid cuts in state operations and also avoid tax increases. The pejorative terms were those used by New Jersey's largest newspaper (Star-Ledger, 6/27) in describing the House version of what became the budget -- "depends largely on blue smoke and mirrors," "a series of magic tricks worthy of Houdini," and "easy money that ... simply isn't there." A non-pejorative way to express the techniques are as deviations from relatively standard budgeting and accounting practices. Some reflect policy decisions, such as shifting more responsibility to local taxpayers for local costs and to students for university costs. Fiscal difficulties clearly made these policies more acceptable to state elected officials than they otherwise would have been. The major policies are listed below:

Costs are shifted from tax revenues to fee revenues. The most common shift was in university budgets. Tuition increases for residents were 22.5% in Massachusetts, 5.5% in New Hampshire (where fees are nearly tops in the nation), 9% in New Jersey, and 59% in New York (SUNY). Fees also went up with a 70% increase reported in Massachusetts and 8% in New Hampshire. Fees for drivers licenses, environmental permits, professional licenses, park admissions, and more were also used.

Local aid is cut. On a continuation budget concept, state aid to local governments would increase by roughly the inflation rate plus or minus changes in workload such as population for many programs and students for school programs. One notion of austerity is to increase local aid only by the amount of state revenue increase, which would be roughly zero in some of the four states. New Hampshire has little local aid to cut. New Jersey withdrew some of the school aid money that was part of the tax and education plan adopted two years ago. New York cut both unrestricted aid to general purpose governments and school aid. Massachusetts cut local aid (which includes school money) by about 15%.

Local governments often got new authority to raise money, including a sales tax increase on Long Island, an income tax increase for New York City, and (pending final approval) new freedoms from Proposition 2 1/2 restrictions on property taxes in Massachusetts. The substitution of local for state taxes doesn't go unnoticed. For example, the Boston Globe's editorial summary (7/2) of the state budget included the comment, "It would be a serious misperception of the situation to call this budget a no-tax document because the reduction of local aid will force many communities to attempt overrides of Proposition 1 1/2..."

Unspecified savings are assumed. **Reports** isn't familiar with the details of each of the four state budgets, but it would appear that some relatively heroic assumptions about savings have been made in accounts where the appropriations aren't really spending ceilings. The Massachusetts budget contemplates savings against current service estimates of nearly 20%. New York's budget assumes savings, modest in FY 1992 and larger later, from moving to managed care in Medicaid.

The Massachusetts budget emerged from the Senate with broad authority for the governor to make cuts administratively in the approved budget. The provision didn't survive in the final version, but the concept of finding cuts after budget enactment did. In Medicaid, for example, the cut is $420 million, about 15% of spending. Within a week after the beginning of the fiscal year, state Medicaid officials were saying publicly that they were unlikely to stay within the budget.

Revenues are accelerated. The best example of revenue acceleration is New Jersey, where approximately $600 million (about $75 per capita) is brought into FY 1992 by accelerated collection of the utility tax.

Assets are sold. New Jersey's budget benefits from $400 million in revenues from selling a portion of Interstate Highway to the turnpike authority. New York sold a prison to a state authority. New York City is selling housing units to the New York City Housing Authority and selling a city-held mortgage on a housing development. The Massachusetts plan has asset sales also, though the governor and legislature haven't gotten together on language or what is to be sold.

Bond funds are substituted for operating money. New York adopted a complex arrangement involving the turnpike authority. Its economic substance is to borrow the costs of aid payments to local governments for transportation. New York City planned to revive the practice of using bond funds for routine maintenance, in this case painting bridges. This specific practice was followed in the early 1970s before the city's fiscal crisis, but ended as part of the reforms to prevent recurrence of the crisis. The city comptroller vetoed revival. However, the search is probably now on for financing with comparable savings in this year's budget without the embarrassing parallel to the practices that led to the fiscal crisis.

Payments are postponed. Postponing payments takes many forms. Several states delayed payments to pension plans. Some are delaying payments to employees by furlough days or shifting payroll dates. Some payments to vendors, to those due tax refunds, and to local governments have been delayed. Debt refinancing and stretchout is apparently a part of the Massachusetts and New York City plans.

Medicaid bootstrap financing is used. Bootstrap financing didn't play a massive role in resolution of budget issues in New Jersey and New York, but it did in the other two states. A federal payment of $500 million was a key element in balancing the FY 1991 budget in Massachusetts, thereby avoiding a deficit to be carried into FY 1992. Bootstrap financing was the key unlocking the door to budget agreement in New Hampshire. It provided enough money so legislators didn't have to decide the hotly contested issue of how to raise business taxes and didn't have to consider adopting a sales or income tax. As the $118 million was included late in the session, it was dubbed the "Massachusetts loophole."

Nothing is held for contingencies. None of the four states have budgeted substantial end-FY 1992 reserve funds, rainy day funds, or balances. No covert reserves appear to be lurking in deliberate overestimates of spending, probably the reverse. In revenue estimates, however, the situation is less clear. A substantial case is being made in Massachusetts -- by a taxpayers group and an economic forecasting firm -- that revenue assumptions are too pessimistic.

Combination strategies are followed. This year's best example of a combination strategy appeared in Massachusetts. Cuts in local aid shifted part of the state's shortfall to local government. The budget legislation set about relieving the resulting pressure on local governments by, among other things, allowing communities to defer certain teacher pay from one fiscal year to the next.

The Consequences Of Budget Magic: The immediate consequences of most forms of budget magic don't appear severe, which explains their popularity. One-shot improvements to balance a budget, shifting costs to future years, and borrowing revenues from future years all improve a present situation at the expense of future finances. So does underestimating spending for Medicaid and other programs. Neither taxpayers nor those affected by spending are likely to notice until some future year. Even in that future year when adverse affects are felt, the association between then-current problems and past actions won't be obvious except to experts.

Rating agencies do notice. Standard & Poor's dumped New Jersey out of the AAA list immediately after the budget was adopted. That will have some effect in increasing interest cost, but an unknown political effect. Massachusetts has a "bottom-of-the-barrel" rating already.

The impact of higher fees, particularly higher education tuition, is difficult to assess because it depends upon future fiscal strategy. New York, for example, went for years without any tuition increase and then adopted a large one. If it follows this by several years of no change, its policy may work out the same as that of a state that makes small adjustments every year. If large increases become a policy, then it, and other states like Massachusetts, could shift to a position like that of Vermont, where state institutions compete with private ones with little subsidy from taxpayers. Without a major scholarship program, the result is likely to be less attendance by middle class youth.

The impact of local aid cuts will probably bring the most excitement to the politics of Massachusetts, New Hampshire, and New York. Having a smaller portion of local costs paid by state aid accentuates the disparities in tax base among small local communities. Indeed, how much equalization to maintain was one of the most difficult issues for the Massachusetts legislature. One choice was cutting all aid proportionately, which affected the high-aid distressed communities most per capita. The alternative was equal per capita cuts, which concentrated the highest percentage cuts on more affluent communities.

Local aid cuts will, no doubt, result in both lower spending and higher local taxes than would otherwise be the case, with no way to determine how much of which has occurred. The effects will likely increase pressures for more state aid from local officials, those who don't like property taxes, and employees like teachers. There is already a substantial movement in Massachusetts for a one-cent higher sales tax for education.

HEALTH CARE FINANCING

Introduction: There is no evidence of any slackening in the cost pressures on state Medicaid programs. Instead, an increasingly key means of financing state contributions is under attack and pressures to raise costs continue unabated.

Bootstrap Financing: State match being put up by provider contributions and dedicated taxes on providers is mounting rapidly to a number like $5 billion in FY 1992. Assuming the worst, this match will be disallowed by the federal government when the prohibition on disallowance runs out on January 1, 1992. This would mean the loss of over $3 billion to states during FY 1992. A few states would be in a position to pass the adverse consequences on to providers, but most wouldn't. The same $5 billion, probably grown to more like $6 billion, will be assumed in the FY 1993 budgets. The maximum state exposure to disallowance is therefore about $10 billion of federal matching funds, which will represent about 2% of general fund budgets. The exposure will not be evenly distributed among states.

These numbers may not be right. No one can know the right numbers because they depend upon decentralized decisions in 50 states. But while the national total is speculative, officials of each state will know how much they have at stake and how it compares to their total budget. ***Bootstrap financing seems destined to be the issue of the year in state-federal relations in 1992.*** Its resolution will spill over into other areas, with probably more public school money at stake in bootstrap financing for Medicaid (with indirect effects on state ability to finance schools) than in the possible changes in federal education funding.

In late June, the leaders of the National Governors' Association indicated their support of continued bootstrap financing. In a letter directed to the Congress, they commented:

> The combined impact of increased demand for public assistance, federally mandated Medicaid expansions, and runaway health care inflation are driving Medicaid costs up at a time when states are also experiencing the fiscal pain that accompanies recent downturns in the national economy.

The governors suggested it was "critical that states retain maximum flexibility to raise revenue to meet the swelling budgetary demands of state Medicaid programs."

Legislators made a similar pitch in a letter from their President and President-elect to President Bush. It objected to federal actions adversely affecting states in five areas: (1) child care regulations, (2) clean air regulations, (3) medical malpractice, (4) mandatory Social Security coverage of some state and local employees, and (5) Medicaid bootstrap financing. It indicated that federal regulations to restrict the practice were apparently being drafted that "would severely restrict states' revenue-raising authority and limit their ability to meet their obligations under Medicaid and to provide health care to their poor and elderly populations."

State Health Notes predicted in its June issue that "odds now are on" the Congressional option of letting the moratorium that protects bootstrap financing lapse. It suggested that states will be shifting from the more risky donations strategy to the less risky provider-specific tax strategy.

In mid-July, the Secretary of the Department of Health and Human Services and the OMB Director issued a press release on Medicaid costs. They noted the rapid increase in state and federal costs and predicted continuing rapid growth unless costs are constrained. It characterized bootstrap financing as "sleight of hand funding schemes" and promised "reforms" in dealing with them that would save $15 billion a year in federal Medicaid spending by the mid-1990s.

Reimbursement Rates: Complaints over state Medicaid reimbursement rates were recently offered by the American Hospital Association and the Physician Payment Review Commission. The Commission found Medicaid rates well below those of Medicare, with considerable diversity among states (see Issue 8).

The Hospital Association concluded that states were paying 78% on the dollar of "cost." It said there was substantial variation in hospital rates as well, ranging from 106% of cost in New Jersey to 53% in Illinois. Critics promptly pointed out that for AHA "cost" is what is seen by the hospital while for states the requirement is reimbursement of cost of an efficiently and economically operated facility. The difference is best seen when a hospital is 50% occupied and a state views efficient operation as 100%. The hospital will perceive a much higher cost per patient than those setting reimbursements.

New Jersey Legislation: New Jersey has now enacted health care legislation which Governor Florio called "a breakthrough for containing health care costs in New Jersey" that "will be a guide for other states to follow instead of waiting for a long-overdue national solution to come from Washington." However, the legislation's key money provision is the old uncompensated care trust fund with a new name. It is funded by a tax of up to 19.7% of hospital gross receipts. The governor and legislative leaders have indicated they don't expect to support renewal beyond the scheduled June 1992 expiration date. The fund is so controversial that it lapsed in January and the legislation to renew it passed by slim majorities.

Among other things, the legislation seeks to shift costs from uncompensated care to Medicaid by expanding Medicaid eligibility and taking steps to ensure that hospital patients who qualify for Medicaid are signed up for the program. A tax of 0.53% of hospital gross receipts will be used for cost containment efforts including expanding community health centers. The concept of a universal plan financed by a payroll tax ($100-200 a worker-year) and employer coverage or a penalty (about $1,000 a worker-year) for not providing it are still under active consideration for 1992 decision, after the 1991 elections.

In his signing ceremony, Governor Florio expressed concerns about financing medical care that parallel concerns being expressed by state officials throughout the nation:

> The high cost of health care is squeezing the middle class of our country dry. It used to be taken for granted that being an American meant receiving the best medical care in the world. Now we're faced with a cruel irony. The care is out there and we've managed to find cures for diseases that used to be death sentences. But too often we've replaced the heartbreak of illness with the heartbreak of bankruptcy.

Medicaid As An Incentive To Be On Welfare: For persons whose jobs provide no medical coverage, or don't cover their medical problem, Medicaid can provide a strong inducement to quit the job. In states that cover the medically needy, a low paying job can be maintained while on Medicaid. In the other states, eligibility for cash assistance is required to be on Medicaid. This is usually inconsistent with holding a full-time job.

No one knows how many people move from work to welfare because of the inducement of Medicaid coverage to deal with expensive health problems. A national audience saw an example involving a traditional (mother, father, child) family on NBC's morning TODAY program (7/9). The 5-year old child has an expensive medical problem not covered by the parent's health insurance. The family was told that government would pay for the child's care if either: (1) the couple abandoned the child who would then become a public ward or (2) the parent quit work and the family went on welfare, and thus Medicaid. The family took the second course, leading to a child successfully treated and a happy family, though unhappy with its poverty, as chronicled for morning viewers.

Although **Reports** is not aware of studies indicating the extent of the impact, it appears to be widely believed that participation in one income-tested program promotes caseload growth in the others. That is, anything increasing participation in Food Stamps, Medicaid, public housing, cash welfare assistance, or smaller programs encourages participation in the others. One theory is that the first participation breaks a psychological barrier to taking government assistance. Another is that the caseworkers for one program point out eligibility and assist with paperwork for the others. For example, USA Today (7/9), in discussing reasons for welfare caseload growth, listed expanded Medicaid eligibility as a reason. It notes, "When Congress extended health coverage to more poor pregnant women and children, many learned, for the first time, that they also were eligible for AFDC, food stamps and other government aid."

State Health Insurance Initiatives: Legislation passed in Iowa this year is indicative of the approaches some states have been taking to increase health insurance coverage with relatively low (and hidden) costs. While the details are complex, the principle is simple. To solve the problem of high rates and/or sharp premium increases for some small businesses, the state is requiring the sharing of the costs and risks. Particularly high premiums develop when a small group has high loss experience because of the high medical costs of one or two employees. Insurers are prohibited from increasing rates by more than 15% just because of this experience and can't cancel the policy because of the past losses. There is no control over cost increases for other reasons and no new limitation on company profits. Therefore, the plan simply spreads the risks. So does another feature designed to deal with small businesses that can't get coverage at all -- an assigned risk pool comparable to that used for auto insurance.

Second, Iowa recognized that some of its own mandates of services to be covered drive up the cost, and drive down the acceptance, of health insurance. So bare bones policies can be offered to employers who haven't provided health coverage in the past 12 months. The state forgoes its 2% premium tax on such policies.

Third, there is a complex plan (with regulations yet to specify details) that is designed indirectly to subsidize coverage for low income workers. For employers who pay 75% of their health care cost, there will be a $25-per-month discount for each low income worker. The insurer provides this discount but the insurer will recoup the discount from the state by an equal reduction in insurance premium tax payments. Recognizing that this could prove popular and expensive, there is a legislative cap of $1.5 million on this deduction.

HIGHER EDUCATION TAKES A HIT

Budget Cuts And Small Increases: In covering state budget actions this year, **Reports** has been suggesting that higher education budgets have been taking a beating in states trying to deal with fiscal problems while avoiding or minimizing tax increases. The early returns -- in the form of a survey of members by the American Association of State Colleges and Universities -- are now in. It suggests that higher education appropriations dropped in about half the states, as shown in Table 1.

Table 1: Percent Change In FY 1992 University Appropriations

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Indiana	21.0%	18	Georgia	3.0%	35	Virginia	-5.0%
2	North Dakota	11.8	19	S. Carolina**	2.5	36	New Hampshire	-5.5
3	Montana	10.1	20	Florida	2.2	37	Minnesota	-6.0
4	Arkansas	9.6	21	Arizona	2.0	38	Vermont	-7.0
5	Utah	8.2	22	Colorado	2.0	39	California	-7.9
6	Idaho	7.1	23	Iowa	2.0	40	Connecticut	-8.0
7	Oklahoma	7.0	24	New Mexico	2.0	41	New Jersey	-8.0
8	Hawaii	6.0	25	Wisconsin	-1.0	42	Rhode Island	-8.0
9	Alabama	5.0	26	Washington	-1.6	43	Massachusetts	-10.0
10	Kentucky	5.0	27	Maryland	-2.0	44	Tennessee	-10.0
11	Illinois*	4.5	28	Alaska	-2.5	45	Oregon	-11.0
12	Maine*	4.5	29	Mississippi	-2.5	46	Delaware	n.a.
13	Missouri*	4.5	30	North Carolina	-3.0	47	Louisiana	n.a.
14	Pennsylvania*	4.5	31	Kansas	-3.5	48	Nevada	n.a
15	West Virginia*	4.5	32	Nebraska	-4.0	49	Texas	n.a
16	Michigan	4.0	33	Ohio	-4.0	50	Wyoming	n.a
17	South Dakota	3.1	34	New York	-5.0			

* Precise percentage imputed by **Reports**, see Technical Notes.

The median increase, according to the survey, will be about 2%, well below inflation. Only eight states exceeded 5%. Those states involved special situations, such as states that felt recession less than other states or states increasing taxes for education. Nearly half the states, with more than half the nation's population, cut higher education appropriations.

Tuition Hikes: The strategy of cutting higher education appropriations but making up some of the difference by higher tuition was common. This accounts for many of the double digit increases shown in Table 2.

Table 2: Percentage Change In In-State Tuition, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	59%	18	Ohio	8%	32	Kansas	5%
2	Connecticut	29	19	Alabama	8	32	Oregon	5
3	Massachusetts	22	20	Michigan	8	32	South Dakota	5
3	Rhode Island	22	21	Oklahoma	7	32	Tennessee	5
5	California	20	22	Indiana	7	32	West Virginia	5
6	Florida	15	22	Minnesota	7	32	Nebraska	5
6	North Carolina	15	22	South Carolina	7	41	Maryland	4
8	Mississippi	14	22	Virginia	7	41	Georgia	4
9	Missouri	12	26	Arkansas	6	43	North Dakota	3
10	Kentucky	10	26	Idaho	6	43	Wisconsin	3
11	Maine	10	26	Utah	6	43	Arizona	3
11	Pennsylvania	10	29	Montana	6	46	Louisiana	0
13	Colorado	9	30	New Hampshire	6	47	Delaware	n.a
13	Iowa	9	31	Washington	5	48	Nevada	n.a
13	New Jersey	9	32	Alaska	5	49	Texas	n.a
13	New Mexico	9	32	Hawaii	5	50	Wyoming	n.a
13	Vermont	9	32	Illinois	5			

Tuition In Texas: The Texas legislature has deferred its consideration of the budget to wait for a comprehensive report on saving money from the state comptroller. That report has now been issued. It suggests substantial changes in the support of the state's well-funded higher education system. Tuition would double for state residents, to $40 per hour, with some of the additional income resulting in a cut of state support. Universities would lose the practice of keeping out-of-state tuition to supplement other funds. The state would, in effect, take credit for university interest earnings and certain health-related revenues. Overall, the state's share of University of Texas costs would drop from 32% to 28%, well below the 45% of 1984.

Implications: For most states, this year's tuition policy adjustment is a slight one that might or might not be continued in more prosperous times. The median state raised tuition 7%, more than inflation, while raising state appropriations 2%, less than inflation. Thirty of the 46 states reporting exceeded a 5.0% tuition increase. If continued for a number of years, the cumulative nationwide effect would be similar to the dramatic one year changes in California, Connecticut, Massachusetts, New York, and Rhode Island.

The perspective of the public institutions on these events is suggested by Richard Novak, who directed the study:

> With well over 50% of institutional budgets comprised of state appropriations, the high degree of sensitivity of public higher education funding to state economic and state budgetary conditions is well known. ... Budget cuts lead to tuition increases, although these increases in no way make up for dollar amounts lost to budget cuts. The tuition increases, often times exceeding consumer price indices and personal disposable incomes in a number of states, are leading to an increased "privatization" of public higher education. States that have prided themselves on low tuition, access and affordability are being forced to put higher and higher percentages of the cost of education on the shoulders of students and their parents.
>
> Something must be done to stabilize public higher education funding from year to year so sharp and sometimes unexpected decreases will not have the disruptive effect they are now having. Until then, we can only hope that state budgets will recover, and subsequently, the funding base for public higher education.

The concept of increasing privatization of public institutions was reflected in a recent statement by university presidents in Virginia. They suggest that, without additional funding, the state may have no choice but to alter the status of some of its well known universities such as the University of Virginia and the College of William and Mary. They would be freed of state controls over tuition and management (e.g., purchasing and personnel) and would attempt to make their way in the marketplace.

DEALING WITH WELFARE

Looking At Welfare: Welfare spending was one of the most stable elements of state costs throughout the 1980s. Caseloads remained relatively stable while state officials opted to increase payments per case less than inflation. This made failures to reform welfare fiscally tolerable, even if socially unacceptable to many observers.

Welfare Reform: Putting welfare recipients to work is a continuing subject of state and federal policy concern. For both cost reasons and because of interest in the recipients' economic opportunity and the images presented for children, encouraging shifts from welfare to work has been of long standing interest. These efforts, often adopted with great fanfare such as that accompanying the national "welfare reform" effort, appear to have had little impact. This has led to efforts to look "beyond welfare reform" (Vol. 8, Issue 11), also with little apparent impact.

Payment Levels: Even in the good times of the late 1980s, states typically didn't increase AFDC payment levels to match inflation. Although the results are not yet compiled, it is unlikely that there were many increases in payment levels in the larger states this year. California broke the historical pattern of indexing its payments for inflation and reduced the cash assistance level by about 5%.

Recent Case Load Growth: Recently there has been a significant increase in the caseloads in the AFDC program, as indicated by Table 3.

Table 3: Percent Change In AFDC Caseloads, July 1989 Through April 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New Hampshire	71.7%	18	Tennessee	25.6%	35	Nebraska	11.3%
2	Arizona	41.1	19	Wyoming	24.0	36	New York	11.1
3	North Carolina	38.6	20	California	22.8	37	Michigan	11.0
4	Kentucky	37.4	21	Idaho	22.4	38	Pennsylvania	10.2
5	Florida	37.1	22	Indiana	21.4	39	Arkansas	10.0
6	Connecticut	36.9	23	Oklahoma	19.9	40	North Dakota	9.3
7	Vermont	35.7	24	Colorado	19.3	41	Kansas	9.3
8	Alaska	35.6	25	Massachusetts	18.9	42	West Virginia	8.3
9	Nevada	35.1	26	Maryland	18.7	43	Ohio	8.1
10	New Mexico	34.3	27	New Jersey	18.7	44	Hawaii	7.9
11	Texas	31.7	28	Montana	17.8	45	South Dakota	7.6
12	Georgia	29.6	29	Virginia	17.0	46	Alabama	7.6
13	Rhode Island	28.9	30	Washington	15.4	47	Iowa	6.8
14	Oregon	28.8	31	Missouri	14.5	48	Wisconsin	2.8
15	Maine	27.8	32	Minnesota	13.8	49	Louisiana	2.5
16	Delaware	27.4	33	Illinois	12.6	50	Mississippi	2.0
17	South Carolina	27.0	34	Utah	12.2			

The median state increase over the 21 month period covered by Table 3 is about 18%, suggesting an increase of nearly 1% a month. The increased caseload automatically converts into increased state costs for cash assistance. It also increases the state bill for Medicaid, as cash assistance eligibility automatically triggers Medicaid eligibility. In addition, it has more subtle cost effects for states in social service programs and even in the amounts due school districts under some state school aid programs. These costs are a major element of fiscal strain in some states that have enjoyed relative economic prosperity, such as Florida and Texas.

Causes Of The Increases: The easy explanation for the increases is recession. In a recession people have a harder time finding jobs and some lose jobs. For lack of a better alternative, the argument goes, they go on welfare. This explanation is comfortable for those who worry about state finances. It allows the cost increases to be blamed on uncontrollable national economic circumstances. It promises relief from the spending pressures at the same time economic recovery provides relief in state revenues.

Recession Not The Only Culprit: Looking at individual state increases in Table 3 quickly leads to the conclusion that economic downturn does a poor job of explaining welfare caseload increases. The Index of State Economic Momentum (Issue 12) provides a measure of relative state prosperity that can be compared with the relative welfare caseload growth. States with the worst economic momentum don't have the largest caseload growth. Some states that are leading the nation in economic performance are leading the nation in caseload growth.

Of the 10 states with the most rapid caseload growth, only three trailed the national average in economic momentum. In the three -- Connecticut, New Hampshire, and Vermont -- a case can be made that the caseload is recession-related. But Nevada was first in the nation in economic growth, yet in the top ten in caseload growth. Arizona and Alaska also showed strong economic growth, but large caseload growth. The ten states with the slowest caseload growth included five that trailed the nation in economic performance: Mississippi, Iowa, Alabama, Ohio, and West Virginia. If recession caused the welfare participation increase, these states would be expected to have higher-than-average caseload growth accompanying their lower-than-average economic performance.

Another major factor appears to be at work. Much of the caseload growth appears to be concentrated in states that have had historically low benefit and eligibility levels. In those states, the federal mandates to cover intact (two-parent) families and perhaps the mandated Medicaid coverages have had an impact. This would explain extraordinary caseload growth in states like Nevada, Arizona, Texas, South Carolina, and Florida.

General Assistance: "General assistance" has been under attack this year in several states. More attempts to cut back the program are likely if these efforts appear to succeed.

"General assistance" is a national term used to group disparate programs that provide cash welfare assistance to those not covered by federally funded SSI and AFDC programs. Needy persons over age 65, blind, or disabled receive Supplemental Security Income (SSI). That program is paid for 100% by the federal government, though some states choose to supplement the benefits. Persons under 19 and the adults in their household are covered by Aid to Families with Dependent Children (AFDC). Non-elderly adults without children get varying amounts of aid under varying conditions from local programs supported by states or, in some states, state programs. These programs, formerly called "poor relief," have names like general relief (Massachusetts) and general assistance (many states).

The plan initially proposed by Governor Weld dealt with 40,000 people on general relief in Massachusetts. They get $338 a month (plus Food Stamps and Medicaid). The governor proposed eliminating the $213 million program and substituting one of "emergency aid for the elderly and disabled." He suggested the current program is dominated by white male recipients, a majority younger than 40 with little work history, "substance abusers, ex-convicts ...."

Advocacy groups argued that cutting out assistance would increase human misery as well as state costs because recipients would fall into more expensive categories such as homeless, prisoners, and hospital patients. Critics of general relief pointed to evidence of fraud in the program. The head of the Massachusetts Taxpayers Foundation summarized the state of knowledge by agreeing there would be some cost spillover into other programs, but he didn't know how much.

The Bay State legislature rejected the overall reforms proposed by the governor, but did restrict eligibility somewhat. However, debates over the program aren't over. As viewed by executive branch officials, the legislature offered a program costing about $180 million while appropriating $116 million.

STATE FINANCES

Ringing In The New Fiscal Year: The new fiscal year began for 46 states on July first, accompanied by more national media coverage than has been seen in years. The emphasis was on the states without adopted budgets, particularly those where there was a hiatus in appropriation authority.

States With No Budgets: State Budget & Tax News counted nine states without enacted budgets at the July 1 beginning of the year: California, Connecticut, Illinois, Louisiana, Maine, Massachusetts, North Carolina, Ohio, and Pennsylvania. In addition, states with late-beginning fiscal years -- Alabama (Oct.), Michigan (Oct.), and Texas (Sept.) -- didn't have FY 1992 budgets and New York (April) was still revising its previously enacted budget.

There were significant lapses of appropriations in Connecticut and Maine. In each case, the governor (R in Maine, I in Connecticut) and the legislature (D-led in both) were in disagreement over major issues. The disagreement extended to whether to use a continuing resolution. Workers lost at least one day and facilities, like Connecticut parks, were closed in each state. State elected officials flirted with similar situations in other states, particularly Illinois and Pennsylvania. Such closings remain a possibility until final budgets are approved in each of the states.

Public Policy And Shutdowns: The short-term shutdowns of state agencies are likely to prove to have been counterproductive in state management. Whether they were productive in producing agreements more quickly than would otherwise be the case or forcing certain conclusions to be included in those agreements isn't subject to generalization.

Employees in short-term shutdowns are typically paid for their lost time, though whether they must be could be argued. In practice, federal and state officials (at least in cases known to **Reports**) decide pay is appropriate for one or more reasons. First, the forced layoff violates collective bargaining agreements. Second, the layoffs on short notice violate civil service laws. Third, the compensation is part of the overall budget agreement. Fourth, the compensation is viewed as appropriate for non-legal reasons such as fairness, compassion, or ensuring good employee relations.

There are no gains for the states in avoided costs for most programs -- welfare checks are unaffected, vendors are ultimately paid what they are owed, etc. There are some losses for the states if revenue-generating activities are discontinued, with tax departments the best, but not the only, example.

Reports knows of no detailed study of this subject at the state level. The General Accounting Office has done one of the parallel federal shutdown of October 1990. The President vetoed a continuing resolution, leaving the federal government without appropriations over the Columbus Day weekend. GAO found the result was "financially counterproductive" as well as disruptive.

The problem of periods without budgets appears considerably worse at the federal level than for states. GAO counts nine "appropriations gaps" in the last ten federal fiscal years, though some of these involve only certain agencies. On average, an educated guess is that there are 3-7 of these in the states each year -- most representing periods of less than 24 hours. The most common gap is the little noticed one between midnight and the wee hours of the following morning as legislatures complete their work under deadline pressures. GAO finds four instances in ten years where appropriations gaps led to some disruption in federal activity. In states, the average is probably 2-4 a year.

GAO recommends permanent legislation that, in effect, would provide continuing appropriation authority when Congress fails to act on budgets in timely fashion. Members of Congress as well as state officials may well resist this idea because it would make it easier to postpone final actions on budgets. There are arguments for facing the issues and timely action at both levels of government. In addition, at the state but not the federal level, postponing action generally means prolonging legislative sessions beyond their scheduled termination.

Public Perceptions Of State Finances: The media coverage often focused on the theme of states being in fiscal difficulties. This was, of course, true. However, the closings drew attention to problems of a few states. Other states did not receive the same attention. Their budget balancing measures -- including the rather severe adjustments made in spending in some states (e.g., Rhode Island) or taxes (e.g., Vermont) -- didn't draw the same attention because their legislatures acted on a timely basis.

Assessing The Outcome: The National Conference of State Legislatures will be releasing its fiscal survey in early August, to be followed by the National Governors Association/National Association of State Budget Officers Fiscal Survey about a month later. Considerably more uncertainty will be associated with the results than in the last few years. First, some key states have left decisions to be made from July through September. This includes the states from the 12 listed above that have late-starting fiscal years by law or by delay past July 1. It also includes states with legislatures coming back to reconsider major decisions such as Tennessee and probably Florida.

There is a significant possibility that expenditures in the enacted FY 1992 budgets will substantially understate what will be spent before the fiscal year is over. The budget submissions of the governors, as reported in the Fiscal Survey, were well below spending growth of past years and current service spending. This may be reflected in appropriations as well, but not necessarily in final spending.

COUNTING THE POPULATION

Counting The Population: The Census Bureau is continuing its consideration of revising the 1990 population counts. The spring 1990 enumeration missed millions of Americans, producing an undercount. Everyone agrees that this occurred, but no one knows exactly how many people were missed. By a variety of mechanisms it is possible to make an educated guess, though the guess itself is controversial.

Possible Revisions In The Census Count: The Bureau's staff released its educated guess in June. It concludes that the total U. S. population was about 254 million rather than the 248.7 million in the count. The correction is an increase of about five million or 2.1%. The correction percentages for each state are shown in Table 4.

Table 4: Increase In 1990 Population From Undercount Correction

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New Mexico	4.5%	17	Hawaii	2.4%	32	North Dakota	1.4%
2	California	3.7	17	Nevada	2.4	32	Vermont	1.4
3	Arizona	3.3	17	Washington	2.4	36	Missouri	1.3
4	Texas	3.2	21	Georgia	2.3	37	Michigan	1.2
5	Delaware	3.0	22	Arkansas	2.2	38	Iowa	1.1
6	South Carolina	2.9	22	Kentucky	2.2	38	Kansas	1.1
7	Montana	2.8	22	Mississippi	2.2	40	Maine	1.0
8	Idaho	2.7	25	Oklahoma	2.1	40	Minnesota	1.0
8	North Carolina	2.7		**United States**	**2.1**	40	Nebraska	1.0
8	Tennessee	2.7	26	Alaska	2.0	43	Ohio	0.8
8	Wyoming	2.7	27	Oregon	1.9	44	Indiana	0.7
12	Florida	2.6	27	Utah	1.9	44	Wisconsin	0.7
12	Louisiana	2.6	29	Maryland	1.8	46	Connecticut	0.6
12	Virginia	2.6	30	New York	1.7	46	New Hampshire	0.6
12	West Virginia	2.6	31	South Dakota	1.6	46	Pennsylvania	0.6
16	Alabama	2.5	32	Illinois	1.4	49	Massachusetts	0.4
17	Colorado	2.4	32	New Jersey	1.4	50	Rhode Island	0.3

Implications For States: In mid-July, the Commerce Secretary decided to use the actual count without adjustment. This decision won't end disputes over the appropriate numbers. Litigation is expected from those interested in representation in Congress and allocations of federal aid.

The adjustments, as shown by the table, are generally adverse to the Northeast and industrial Midwest while favoring the Southwest and California. They would add a Member of Congress for Arizona and California and subtract one for Pennsylvania and Wisconsin.

Adjustments have major impacts on federal aid. First, they impact all aid that is provided on a per capita basis. More important for states, they enter the calculation of the federal cost-sharing percentage for AFDC and Medicaid. That percentage depends upon per capita income in each state relative to the nation. Other things being equal, larger population means lower per capita income and higher federal cost sharing percentages.

Adjustments Within States: The adjustments become less reliable as the size of the jurisdiction affected decreases. That is, an adjustment suggesting 1.2 million Hispanics were missed nationwide is likely to be more reliable than one suggesting that 300,000 were missed in California. A California estimate will be more reliable than 50,000 for Los Angeles, which will be more reliable than 300 missed in Compton, which will be more reliable than two missed in a particular Census track in Compton. This problem is one of the arguments against making any adjustment.

In general, adjustments within states favor the larger cities relative to the suburbs. Some of the more extreme adjustments are shown in Table 5.

Table 5: Change In 1990 Population From Undercount Correction

Jurisdiction	State	Type	Percent
Atlanta	Georgia	City	5.1%
Independence	Missouri	City	0.6
Inglewood	California	City	10.9
Livonia	Michigan	City	0.1
Lowell	Massachusetts	City	-0.4
New York	New York	City-County	3.0
Stamford	Connecticut	City	-0.1
Albany	New York	County	0.8
Beaver	Pennsylvania	County	-0.1
Los Angeles	California	County	4.6

The examples in the table suggest the difficulties that can arise in translating any Census adjustment to political subdivisions. These difficulties would affect reapportionment and distribution of state aid in some programs and states. Some state aid is on a per capita basis. A few states also use per capita figures for calculating relative fiscal need, so additional population means greater state aid.

It would be possible to reflect presumed Census undercounts in state and federal aid formulas despite the Commerce Secretary's decision on the count to use for apportionment.

MISCELLANY

Defense Impact On State Economies: There is continuing nervousness about the impact of defense budget changes on state economies. While much of the publicity is associated with base closings, many states have large stakes in defense procurement. David Whitehead (Federal Reserve Bank of Atlanta) recently attempted to assess the impact of private-sector defense cuts on state economies (Economic Review, March/April). His calculation of the percentage of employment associated with defense contracting appears in Table 6.

Table 6: Defense-Related Private Employment, Percent Of Total Employment

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	7.9%	17	Hawaii	2.7%	34	Michigan	1.1%
2	Massachusetts	7.0	18	Georgia	2.6	35	Oklahoma	1.1
3	Virginia	6.8	19	Minnesota	2.6	36	Vermont	1.1
4	Missouri	6.0	20	Ohio	2.6	37	Iowa	1.0
5	Alaska	5.7	21	Florida	2.5	38	Wisconsin	1.0
6	Maryland	5.0	22	New Mexico	2.5	39	Nevada	0.9
7	California	4.9	23	Alabama	2.4	40	North Carolina	0.9
8	Arizona	4.7	24	New Jersey	2.2	41	South Carolina	0.9
9	Mississippi	4.4	25	Rhode Island	2.2	42	Illinois	0.8
10	Colorado	4.1	26	New Hampshire	2.1	43	Nebraska	0.8
11	Utah	3.3	27	Indiana	2.0	44	Wyoming	0.8
12	Washington	3.3	28	Louisiana	2.0	45	Kentucky	0.7
13	Texas	3.2	29	Arkansas	1.9	46	Oregon	0.6
	United States	**3.0**	30	Pennsylvania	1.8	47	South Dakota	0.6
14	Kansas	2.9	31	Delaware	1.6	48	Montana	0.5
15	Maine	2.9	32	North Dakota	1.4	49	West Virginia	0.4
16	New York	2.9	33	Tennessee	1.3	50	Idaho	0.3

Whitehead assesses the ability of states to absorb defense cuts by normal employment growth. He concludes that five states -- Colorado, Connecticut, Massachusetts, Missouri, and Virginia -- will have the most problems in economic adjustment.

Economic Benefits Of Spending Money: With cuts being considered for just about everything in just about every state, this year has seen a bumper crop of studies justifying spending. Many of these have broad economic rationales, such as tying education to economic growth. One category of these studies deals with federally matched programs. They suggest benefits independent of what the program does, just from the in-state spending effects and the state and local taxes on the resulting economic activity.

An example is a study, (Alan Sager, *Shooting Ourselves In The Foot*, Boston U. School of Public Health) reported in *State Health Notes* (June). The math is shown in Table 7 for: (1) the Massachusetts Medicaid program (50% federal match) calculated by the study, (2) Medicaid in a state with 70-30% match calculated by **Reports** using the study's logic, and (3) the 70-30% situation calculated by **Reports** using values more common in economic analysis of public investments. The table addresses what impact would occur from a state decision to cut Medicaid spending (state and federal) by $500 million. The same math would be used to calculate the net cost of expanding Medicaid.

Table 7: Calculating Net Costs of A $500 Million Reduction
($ millions)

	BU Method		Reports
Category of Impact	50% Match	70% Match	70% Match
Total Program Cut	$500	$500	$500
State Savings	+250	+150	+150
Lost State Tax Revenue	-89	-125	-32
Extra State Non-Medicaid Spending	-25	-25	-5
Equals Net State Government Saving	+136	0	+113
Extra Costs Spread By Provider Charges			
Local Government	-18	-18	-18
Rest Of State Employers and Patients	-50	-50	-50
Equals Net Savings To State	+68	-68	+45
Total Job Loss	5,690	7,966	7,000

There are many controversial issues behind each of the entries in the table. But there are also some points about the economics of federally matched programs, particularly Medicaid and highways, that have been strong motivators of state policy. First, in the 70-30 match situation, the state cost is extremely low even with the more conservative calculations done by **Reports**. The added federal money is itself economic activity that will be subjected to state income and sales taxes. In many cases, including highways and Medicaid, it will supplant some state spending that would otherwise take place with 100% state or local dollars. Using the BU logic, which approximates that used by provider groups in other states and circumstances, the 70-30 program is costless for state government, and thus nothing is to be gained by cutting it.

The lower half of the table reflects the tendency of unreimbursed health care costs to be distributed to other health care buyers. Taking those effects into account makes participation in Medicaid inexpensive compared to the apparent match, such as reducing an apparent $250 million Massachusetts cost in the BU calculation to $68 million. If private benefits are taken into account, expanding the program looks even better. On the BU calculation, the $68 million in state money is buying or maintaining over 5,000 jobs.

These calculations are by no means academic. Despite the austerity environment of New Jersey budgeting this year, expanding the Medicaid program was a key element of the health care legislation passed at the end of the session. Expanding Medicaid even more was a key element of the health care task force recommendations endorsed by many labor and management leaders, but not passed. The recommendations for improving the Texas budget situation that the comptroller is offering to a special legislative session have a major element of Medicaid expansion.

Gambling: In addition to actions mentioned in Issue 13 to expand legalized gambling, South Dakota upped the betting limits for the successful Deadwood blackjack tables from $5 to $25.

Tax Amnesty: Tax amnesty plans have been less popular than when an initial round of interest and plans developed several years ago. This isn't surprising because many of the plans were conceived as one-time efforts. The logic was that increased enforcement efforts, and sometimes more stringent penalties, would begin immediately. Taxpayers would have a limited amnesty period to make good their obligations. This rationale loses credibility if repeated.

But amnesty plans have proponents. First, about a third of the states haven't conducted formal programs. Second, amnesty inherently accelerates the collection of some money that would be collected sooner or later, even though the emphasis is on collecting money that wouldn't otherwise be collected at all. This puts amnesty into the family of fiscal practices that move money to the budget year at the expense of future years. For example, an amnesty plan was part of Maine's budget balancing package last year.

There were lively debates in some states over amnesty proposals originating in the legislatures and opposed by the executive branch. The Ways and Means Committee surfaced one in Massachusetts. The revenue commissioner testified that there was little to be gained from the plan, arguing the state might jeopardize future collections by offering the second amnesty in ten years. Republican legislators in Pennsylvania made several proposals. The tax agency nixed the proposal and suggested it didn't want taxpayers to believe amnesty was under serious consideration because they might delay paying taxes to take advantage of it. There were similar discussions in Florida, Illinois, New York, and probably other states.

The definitive work on concepts of amnesty and what states have done what with what results is State Tax Amnesty Programs published last year by the Federation of Tax Administrators (444 North Capitol St. NW, Washington, DC 20001).

Tax Administration And Budget Balancing: No one keeps statistics on the relationship between tax administration and the overall state budget balancing strategies.

One pattern is to respond to fiscal problems by placing more emphasis on tax collection. This includes increasing budgets for revenue collecting agencies and associated activities, such as collection activities of attorneys general. Such plans and budget allocations are often accompanied by explicit increases in the revenue estimate used in the budget. This approach was explicitly developed in New Jersey, New Mexico, North Carolina, and probably other states.

In some other states, revenue collection functions are being subjected to government-wide policies like furloughs, hiring and travel freezes, and early retirement. The pattern has probably spread to applying decision rules, such as no expansion of programs, to the tax collecting agencies.

TECHNICAL NOTES

Rabbits Out Of A Hat: Tax increases, as defined by State Budget & Tax News, do not include renewal of levies scheduled to expire like the Illinois income tax surcharge being renewed this year or the continuing postponement of New York income tax cuts. SB&TN does count as tax cuts the rare case of a scheduled tax cut that takes place. Besides Massachusetts, there were probably a couple of other states with small tax cuts as part of economic development promotion.

Higher Education: AASCU's report is Report Of The States: 1991 Annual Budget and Fiscal Survey (Updated). The organization operates from Suite 700, One Dupont Circle, Washington, DC 20036. The states designated "*" reported that the allocation was likely to be the inflation rate while the response noted "**" indicated an increase below inflation. Non-respondents are smaller states not in AASCU and larger ones where university officials wouldn't venture a guess. Not all the guesses made in states without budgets when the guesses were made (e.g., Pennsylvania) will prove correct. California's response is the state university system (CSU not UC) and New York's is SUNY not CUNY. Rankings in Table 2 reflect fractional percentages reported by some state officials but not reprinted in the table.

State Finances: The General Accounting Office (Washington, DC) report issued in June is Government Shutdown: Permanent Funding Lapse Legislation Needed.

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August 1991 (First of Two August Issues)

AIR WARS, FINANCING PLANES AND AIRLINES

States And Aviation: Although the airline industry is undergoing a well publicized shake out, the industry is showing enough prosperity to be one of the few planning new facilities. State efforts to attract planned new maintenance facilities have been major issues in Colorado and Minnesota. Competing for a United Airlines maintenance base and a possible McDonnell Douglas plant has attracted attention and financial commitments in about a dozen states.

McDonnell Douglas: McDonnell Douglas has been talking with government officials about a plant to build a possible new MD-12X airliner. Eight communities are said to be in the running: St. Clair County (IL), Fort Worth, Houston, Kansas City, Mesa (AZ), Salt Lake City, Shreveport, and Tulsa. The company's major facilities are in St. Louis and Long Beach (CA). The company is using a formal procedure with candidate communities including: (1) providing its wish list, (2) soliciting proposals, and (3) assessing the proposals and making a decision.

The wish list includes utility and transportation services such as roads to the site, rail connections, fire protection, electric service, water supply, and sewage treatment. Most utilities and governments would routinely provide these for large activity centers without special charge. The company wants a 600 acre site, presumably free, graded and with interior roads, along with zoning that prevents residential construction within three miles. For personnel, it wants relocation expenses of employees, free recruitment and screening of new workers, 12-24 weeks of basic skill training of up to 8,000 employees, and additional training both initially and in future years. The company wants to spend $1.4 billion on facilities and equipment and borrow all of it "off balance sheet." The only way **Reports** knows to keep this kind of debt off the company's balance sheet is to put it on someone else's, such as the state or county. Then government or bondholders, not the company, would bear the risk if the facilities weren't used.

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Many communities are serious about the competition. The State of Kansas and some of its local governments are contributing to the $250,000 Kansas City expects to spend on the proposal. Kansas City is putting a property tax increase of 0.25% of assessed value on its ballot this year to pay for infrastructure. The group pushing passage of the measure has been advertising that the plant would be "more than a $10 billion boon to our economy." An opposition group has been formed by leaders of the Heartland Institute. They contend that the power of taxation shouldn't be used to benefit an individual company and that benefits are exaggerated.

The other seven communities will apparently propose as well, though not necessarily meeting all the terms of the wish list, particularly the term suggesting off-the-books debt. In late July, the company announced that it had enough potential plane purchasers lined up to make a production decision but lacked investment partners. This may suggest a delay in the plant location decision.

Northwest Airlines: The deal between the State of Minnesota and NWA Inc. isn't final. There are agreements yet to be worked out and approvals required from an advisory commission. But the deal is impressive in many dimensions. It involves $800-900 million for a single company. This includes industrial development bond financing of maintenance and repair facilities in Northeastern Minnesota (near Duluth). In addition, the state will forgo corporate income and sales tax revenues estimated to be $40-55 million. The significant precedent is the promise of $300 million or more in direct financing of the company by the state or its instrumentalities (e.g., the Metropolitan Airports Commission and the State Board of Investment). Also striking was the speed with which the company, the parent of Northwest Airlines which is based in Minnesota, and the legislature acted. They moved from an idea viewed in April as not likely to be seriously considered to having enacted legislation in May.

America West Airlines And More: If some states are to team up with "their" airlines as Minnesota has done, a whole new form of competition could develop. Other states would be presumably be asked by other airlines to provide similar help. In the extreme case, there would be state carriers comparable to carriers in the international market like Air France. This competition would only be restrained because states couldn't restrict landing rights (controlled by agreements under which they received federal airport financing) nor provide discriminatory taxes (prevented by the Commerce Clause of the U.S. Constitution). Is this farfetched? The Arizona Republic (6/23) tells the story:

> America West Airlines is preparing to ask Arizona and Nevada for financial aid that could total tens of millions of dollars. The amount likely will far surpass

> anything Arizona has ever considered for business assistance and touch off a major political row.
>
> The company's top executives say they must have the incentives if they are to remain competitive with airlines that are getting lucrative packages from other states.
>
> Last month, Northwest Airlines got a $740 million aid package from Minnesota. Colorado is offering United Airlines more than $300 million to build a maintenance base in Denver. Texas is considering a huge aid package for Continental Airlines, which is in Chapter 11 reorganization under the U.S. bankruptcy code.
>
> America West will ask that Arizona or Nevada form an economic partnership with the airline.

The company's president indicated that its request for aid would be based "on what it is going to take for us to continue to be competitive in light of this new kind of partnership that seems to be developing between certain companies and the states in which most of their personnel reside." Noting the action of other states, he asked whether Arizona was going to act, "or is the rest of the world going to pass it by?".

United Airlines: The United Airlines maintenance base looks like a development plum to competitors. Virginia enacted special legislation to have something to bring to the bargaining table. Oklahoma City voters passed a local tax increase for the same reason. Other states and localities are acting to keep competitive.

One was Denver where the facility provided possible major linkages with a new airport. By May, the Colorado package had evolved into special legislation designed to provide employment tax credits of up to $2,000 per employee-year for workers at the maintenance facility. Unlike most corporate tax credits, these would be fully refundable. Thus, the economics would be the same as writing the company a check every year for $2,000 times the number of jobs for each year of the agreement. At 7,000 jobs, the price to Colorado taxpayers would be $14 million a year in subsidies plus a package that included other concessions. Run over thirty years, the package would cost over $400 million. Translated into the amount the state would have to put into a trust fund if it wanted to prefund the deal, the cost (present value) was just over $200 million.

There were cost-benefit studies which showed that the deal would pay for itself in added tax revenue or, depending on the study, that it wouldn't. The studies distinguished between jobs to be filled by in-migration and jobs to be filled by those currently in Colorado. The logic was that both would bring income to the state, but in-migrants would also bring new costs for school and other public services. Editorially, the Denver Post (5/16) endorsed the proposal, noting that in another deal "it's obvious that Minnesota is offering three our four times as much as Colorado."

Significant opposition had developed by the June special legislative session called to approve the package. By the time it emerged from the legislature, the package was no longer a refundable tax credit but an up-front subsidy of about $115 million paid out over several years. The company would also get about $33 million in enterprise zone benefits by extending a nearby zone to cover the site. In addition, Denver would provide separate incentives. To avoid a constitutional prohibition against special interest legislation, the bill was set up with general language. The money would come from tax-exempt borrowing with debt service paid from the aviation fuel tax.

CLAWING AND SCRATCHING FOR DEVELOPMENT

Introduction: With the economy floundering, businesses are closing facilities, not opening new ones. This makes it hard for states and localities to compete for economic development because few prizes are being offered. Economic recovery should bring more prizes. If the few instances of current competitions are prologue, the competition will be stiff.

Competitive Strategies: In broad terms, there are two approaches to development, the particular and the general. They aren't mutually exclusive but are often discussed as though they were.

The particular strategy concentrates state resources -- from the scarce time of the governor and community leaders to subsidies and tax exemptions -- on individual targets. These aim at specific decisions of individual firms, such as a new plant or an expansion. The advantage of the strategy is that it conserves resources by not dissipating them over all existing businesses. For example, it is considerably cheaper to provide a concession to a single firm than to all firms. The main disadvantage is that the strategy is inherently unfair in the sense that it provides more of value to potential new investments than to existing ones. Another disadvantage is that it assumes negotiations with a firm considering multiple states. So it can't work for firms which don't enter such negotiations. States closely identified with this strategy are Texas and many Southeastern and Midwestern states, but nearly all states do some of it.

The airline examples in the preceding article show the particular-firm strategy at work. Past major examples include the competitions for private auto investments, like GM's Saturn plant, and government investments like the supercollider.

The advantage of the general strategy is its evenhandedness. It doesn't involve the appearance of playing favorites nor pull state officials into lengthy negotiations. The primary disadvantage is that states pursuing it may not be able to offer competitive proposals in dealing with firms looking for concessions. Because the state strategy is general policy open to all, it can be more expensive than what might be offered to a single firm. Examples of states emphasizing general business policies rather than firm-by-firm concessions range from New Hampshire to California.

Arkansas And Oregon Development: Oregon indicates the high level of economic development legislative activity in some states this year. The summary of what was done consumes 27 single-spaced pages. There is a new major program for dealing with the state's major economic dislocation (timber cutbacks) with business loans and public works projects in the affected communities. There is a new dedicated revenue source for capital construction, state operation of video lottery terminals. There is a new rural development package creating a non-profit corporation to help rural areas with strategic planning, technical assistance, and leadership training. There is also a special board to define benchmarks and monitor economic development projects. There are new job training efforts aimed at the objective of having the best trained workforce in the world by the year 2010.

New Arkansas legislation includes specific goals to be achieved by the year 2000 on such subjects as per capita income, average annual pay, average unemployment duration, and the poverty rate. Mechanisms are established to report on achievement of the goals.

Expansion Of State Development Efforts: State development activity appears to be increasing, even in recession. There is, however, no way to test this statement quantitatively. The budgets of state development agencies can be measured and compared, but the big money in economic development is outside those budgets. That big money, such as the money used to encourage the supercollider investment in Texas, is in university research budgets, the price of training commitments made by community colleges, decisions by state and local revenue bond agencies, and in tax policy decisions at the state and local level. Often, as in the many states where four-lane highways are being constructed to connect smaller communities, there is room for considerable argument over what portion of the investment should be considered driven by economic development.

Counting programs, regardless of cost, is difficult. The matrices of programs and states in the periodical Site Selection seem to grow every year. The National Association of State Development Agencies compilation of programs appears to grow each time it is issued. NADA also keeps data on state export programs which suggests how fast some state development programs are growing. From FY 1988 to FY 1990, spending on these programs grew by 58% to $92 million while the number of state foreign offices grew from 108 to 163.

Site Selection (June) provides an example of the proliferating state programs for high technology industries. These include technical assistance, university cooperation, and some programs potentially involving substantial outlays or revenue losses. They include R&D grants in 38 states, state funds for research parks in 26 states, and R&D tax credits or exemptions in 32 states.

Future State Policy: All the forces seem in place for a substantial expansion of state business incentives embedded in the tax code, particularly in the form of credits against the corporate income tax.

High rates of joblessness have elected officials looking more diligently than usual for ways state policy can contribute to economic development. These almost all involve money which will be more readily available in recovery than in recession. Investing in a single firm will remain popular, but raises concerns about evenhandedness among firms, criticisms if the firm and thus the investment fail, and violations of constitutional provisions and the policies behind them. Tax expenditures cost money, reduce the percentage of state spending financed by business, and make tax codes more complex. But they are comparatively simple to administer and inherently evenhanded.

Opposition comes from the right and left. From the right, as typified by New Hampshire policy in general and former Governor Sununu's perspective in particular, tax laws shouldn't have a lot of special preferences. Instead, a state should present an overall strong business climate and then shouldn't need special incentives. From the left, the tax expenditures are viewed as tax loopholes benefiting business and thereby forcing more of the tax burden onto individuals.

More toward the center, there are many leading figures in both parties who find tax expenditures acceptable. They are in the proposals, platforms, and legislative programs of many of the newly elected Republican governors, with Governor Weld an example. They also appear in some Democratic proposals. Passing the R&D credit in Massachusetts this year was the work of House Democrats as much as Governor Weld. In a recent speech at the American Stock Exchange, Governor Cuomo endorsed an investment credit (as well as a tax cut on capital gains from productive assets held for long periods). He was addressing Democratic perspectives on national, not New York, issues. But an investment credit can't be good policy at the federal level and a moral outrage at the state level at the same time. In New Mexico, the governor and others are backing removing research and development services from the base of the gross receipts tax.

While Democratic legislators in Massachusetts were passing their R&D credit, Republican legislators in New Hampshire were providing a credit of 15% of compensation costs for newly created jobs and an investment credit for small business. Both states would be on anyone's list of states that could least afford revenue loss.

Drawing The Line: Deciding where to draw a line to conclude that luring a large investment isn't worth the expense isn't easy. Theoretically, some sort of consensus or economic equilibrium would develop eventually based on the economics of the situation. That is, states that invested too little or too much would recognize their errors and adjust so state policies would more or less converge.

But there are other factors at stake. First, being responsible for losing a development plum has a political cost to elected officials over and above any net benefits (or net costs) from attracting the facility. Second, there are massive intangibles associated with spin-off developments. For example, officials of St. Clair County (outside East St. Louis) may not see just a large aircraft plant, but see their area becoming another Seattle. Third, losers from plant subsidies aren't often heard from. Winners are those with fixed investment in a community who benefit from more economic activity, such as newspapers and TV stations. Losers include those not helped economically who lose through increased congestion and taxes, such as retired persons.

The case for going all out was expressed most forcefully in a mixed metaphor by Kansas City's mayor in June. In discussing putting a tax measure on the ballot, he indicated that the plant was "the greatest economic development opportunity for Kansas City during this century. He continued, "If we fail to put forth a full-court press, it would be tantamount to shutting a window on our hand."

Constitutional Factors: Finding a way for Arizona to take a stake in Air West is difficult because the state constitution has a prohibition against the state lending its aid or credit to a private party. The prohibition, which appears in many state constitutions, was drafted to prevent exactly what Air West wants Arizona to do -- use taxpayer money to assist a private company in the hope it will create jobs for residents and markets for merchants.

In the early 1800s, waterway construction by private canal companies was widely viewed as the key to economic development. Many states provided subsidies and lent money. As a result of corruption, unanticipated costs and construction problems, and changing marketplaces, many of the canal companies folded. This left the states with no return on their subsidy investment and debts to cover out of tax revenues. Reacting to this fiasco, many Eastern and Midwestern states put the "aid and credit" prohibition in their constitutions. Western state constitutions were often modeled on them.

With no memory of their origin, those interested in development dismiss the provisions as anachronistic and seek their repeal, which has happened in some states. But not all. In New Mexico, for example, Governor King opposes eliminating the constitutional provision that forbids using public money to further private interests.

There are residues from the era of public-private partnerships. In mid-June, the State of Virginia completed a deal that unwinds its stake in the Richmond, Fredericksburg & Potomac Railroad, which was an investment made in 1834. The state, which turned its investment over to its pension fund decades ago, loses its minority shareholder status in the railroad. It gets valuable Northern Virginia land previously used as a rail yard. In Wyoming, which has a constitutional provision forbidding aid to railroads, the attorney general has recently ruled that the state cannot enter into subsidy contracts with Amtrak.

GOVERNING TEXAS

Special Session: When they met earlier this year, Texas legislators made extensive and expensive revisions to their school aid formula to satisfy a court order for equalization. But they decided to defer considering the budget for the fiscal year starting in September. The problem was a gap of $5-7 billion in a biennial budget of about $50 billion. Instead, they opted to schedule their budget session in July and commissioned a report from the comptroller on how to save money and one from a blue ribbon group on how to raise it. Predictably, the 1,000 page report on saving money has drawn the most initial interest. It sold out its initial printing and reprints are reportedly selling quickly, aided by marketing devices such as a special number for ordering it (800-BEAT-WASTE).

Tending The Ranch: The governor opened the session by talking about horses. She described a West Texas rodeo event in which one of the cowboys tries to settle a wild horse down by biting its ear. She said, "We are biting the ear of government -- settling it down long enough to get a saddle on it and turn it into a workhorse." Her reference was to recommendations on state reorganization in the comptroller's report. They include consolidation of smaller agencies, replacing agencies headed by boards and commissions with ones headed by appointees of the governor, and establishing new major departments of environment and transportation. Switching to cows, the governor urged that "no agency of government is a sacred cow." Back to horses, she reported that she, the lieutenant governor, and speaker had worked hard to reach agreement: "We have led the horse to water. But only you in the Legislature can make it drink."

Avoiding Major Tax Hikes: There seems to be general agreement that the savings promised by the comptroller's report and non-tax revenue measures will minimize the gap in the biennial budget. This might make it possible to avoid tax increases entirely, except for some revenue raising incident to revisions in the corporate franchise tax. Because of past litigation and widespread perceptions of unfairness, there is considerable sentiment for revising the tax whether additional revenue is needed or not. The legislative leaders and the governor have endorsed putting a lottery proposal on the November ballot. These measures along with savings and non-tax revenues recommended in the comptroller's report make serious consideration of an income tax unlikely. If tax increases are adopted, the local betting is on raising the rate, and/or expanding the base, of the sales tax.

Looking For Money: In its 1,200 pages, the comptroller's report has room for lots of fine print. Many of the savings are associated with making available for the general fund resources that otherwise would be in some other fund. Many of the higher education recommendations are of this type, triggering a long debate between the comptroller's staff and university officials on who was using the right numbers. There would also be a major consolidation of special funds, creating five "superfunds" from 301 separate funds. A scheduled sales tax exemption for machinery would be delayed, increasing revenues by nearly $400 million. Businesss would lose certain discounts for prompt payments of taxes.

The report contains many facts about state government common to states other than Texas. One which often surprises observers is the number of people paid more than the governor. In Texas, the governor makes $93,432 per year and 1,950 state employees make more. Large categories of such individuals are typically higher education administrators, doctors and psychiatrists at state institutions, prized college professors, and persons working extraordinary amounts of overtime. Texas spends about $600,000 a year for foreign travel. It spends enough reimbursing employees for using their own cars to pay for 243 round trips to the moon.

Possible Problems: Texas legislators are understandably enthusiastic about the prospects for a session involving few tax increases and none noticeable to the public. A session that produces widely hailed cost-cutting is also a delightful prospect. But the session is likely to have difficult aspects as the legislature works through the nitty-gritty of the budget. One major concern is prison construction, with a large and expensive program likely. Another will be the costs of social service programs, which aren't likely to be greatly affected by reorganization.

HEALTH CARE COSTS

Health Costs: Rapidly rising health care costs continue to put immense indirect cost pressures on Medicaid, as well as increasing pressures for federal and/or state action. The major indirect effect appears in escalating costs of employer plans. The higher costs discourage employers that don't offer plans from adopting them and encourage employers with plans to drop them. For plans remaining in effect, the higher costs encourage employers to use larger copayments and exclude more coverage, putting Medicaid at risk when employees incur bills they cannot pay. They also encourage employers to make family coverage optional, an option often rejected when expensive to the employee. Finally, they encourage employers to increase employee cost sharing, leading some to drop their coverage.

Many illustrations could be chosen. The recent filing of Empire State Blue Cross and Blue Shield for the New York City area has higher numbers than elsewhere, but illustrates the problems. The state insurance department must approve the rates, but is likely to do so or at least approve rates that generate about the same total revenue for Empire State. To deal with competition from private companies, the firm will stop offering a blanket rate for all group coverage. So groups with good risks will pay just over $5,000 an employee-year for family coverage, a decrease of about 15%, while groups with more risk will pay about $9,000 an employee-year, an increase of about 50%. A typical individual policy will be about $11,000. Empire raised its rates about 20% this spring and 14% last year.

Medicaid Costs: There is no evidence of any slackening in the cost pressures on state Medicaid programs. The revised federal budget estimates released by OMB in July presume a 16.2% increase in FY 1992 federal Medicaid costs, which implies a nearly identical percentage increase for state spending. Pressures to raise reimbursement rates continue as health care providers increasingly turn to the courts.

Medicaid Expansion? When federal officials, health care provider groups, and those concerned with reducing the number of uninsured consider policy options, Medicaid expansion often rises to the top.

Four major health organizations -- representing doctors, hospitals, Blue Cross and Blue Shield, and health insurers -- recently have endorsed Medicaid coverage for an additional 10 million people who are below the poverty level and don't have other coverage. An advisory panel appointed by the President is reportedly moving toward a similar recommendation.

A continuing expansion of Medicaid is one of three choices in a new Congressional Budget Office study, Selected Options For Expanding

Health Insurance Coverage. The other two are mandated employer coverage and a combination of more employer coverage and more Medicaid coverage. Under the Medicaid option, all persons below poverty income levels would get free coverage. Those with incomes between 100% and 200% would "buy in" to Medicaid with a sliding scale of contributions. The Medicaid option would increase recipients from 14.6 million now to 25.3 million, plus another 6.8 million that would have Medicaid coverage on top of Medicare or private health insurance coverage. Under current cost sharing arrangements, the Medicaid expansion would cost states nearly $12 billion. CBO says this "would cause a major funding crisis for the states."

The study has a table showing what the aging of the population will do to Medicaid costs. In 1991, the average cost for female recipients -- there are slight differences for males -- was $656 for recipients under age 18. This rises to $1,382 for those in their late 30s, to $2,077 for those in their late 50s, and to $4,128 for those over 65. States pay about 43% of these costs with state shares as high as 50% in more affluent states and below 20% in the less affluent.

Another CBO study, Policy Choices For Long-Term Care, addresses specifically the costs primarily associated with serving an elderly population. Over three-fourths of long term case costs were in nursing homes. Medicaid pays about half these costs. Medicare, which doesn't cover long term stays, covers only about 2% of the nursing home bill. The rise in the elderly population alone suggests Medicaid costs will escalate, but the prospects for cost-containment are "bleak" because individuals are already required to exhaust most of their own resources before using subsidized care and the range of subsidized services is narrowly defined.

As with the case in the CBO health insurance study, many of the options would increase costs for states. One would mandate a minimum personal needs allowance, the amount a patient is allowed to keep. Another would broaden eligibility by mandating a change in the income thresholds. Steps to broaden the use of home health care would have uncertain effects -- cutting costs by diverting persons from nursing homes and increasing costs by providing help to people who don't now receive Medicaid services.

The report also considers broader options for altering the federal-state division of responsibility. One would shift responsibility to states along with a block grant. The other would provide for increased federal responsibility for the long-term care population.

BOOTSTRAP FINANCING AT RISK

Increased Use Bootstrap Financing: Medicaid bootstrap financing (Issue 14), an increasingly key means of financing state Medicaid matching funds, remains under attack. The returns are still coming in, but it is clear that a substantial interest in bootstrap financing coincided with the need of end-of-session negotiators to find new revenues in politically acceptable ways. This resulted in bootstrap financing devices being adopted with little notice or debate.

The latest example is Washington, where legislators ended their regular session with a teachers' strike and without a budget agreement. Everything came together in late June when added money appeared from a revision of the revenue estimate and a decision to rely on bootstrap financing. In Kansas, the Finney Administration has announced that a $30 million windfall may conveniently match a $20 million problem created by a judicial decision requiring continuation of public assistance to some recipients cut off in the FY 1992 budget. The chairman of the Senate Ways and Means Committee cautioned that the federal "loophole" would probably be closed soon and expressed concern about using the added purchasing power for welfare rather than health care.

One state budget official, speaking off the record, called the action in the states a "feeding frenzy." He said his state would never have made the spending commitments it did "if the money hadn't seemed free." In his large industrial state, bootstrap financing provided enough money to "delay the day we come to some kind of reckoning" with spending patterns that seem to exceed available revenues. In Illinois, legislators moved through July without a budget, but had no trouble accepting a $300 million item to be financed with hospital fees to help close the budget gap.

In states that have used provider taxes or donations for several years, the costs of the program are growing as the practices become more familiar to, and accepted by, state officials and health care providers. In Georgia, the governor recently announced that $242 million will be allocated to hospitals this year. This is up from $88 million in FY 1990. Arkansas is using the money from its new dedicated tax on providers to restore Medicaid benefits for those not receiving cash assistance (the medically needy). Their coverage was dropped last year for fiscal reasons.

The Coming Battle On Bootstrap Financing: ***Bootstrap financing seems destined to be the issue of the year in state-federal relations in 1992.*** Many states have enough money at risk so that the outcome could mean the difference between raising taxes or not in the 1992 legislative sessions.

Images Of The Practice: In arguing with federal officials, state officials will be at an initial disadvantage because of poor images of the practice in the press and media. An example is "How States Cook The Books: Step 1: Inflate Medical Fees. Step 2: Make Uncle Sam Pay For Them," U.S. News (7/29). The magazine quotes Maryland officials as calling the practice "Fool the Feds" and also uses **Report**'s non-pejorative phrase "bootstrapping." Officials of other states have used phrases like the "second Massachusetts miracle" and the "Massachusetts loophole." The Seattle Post-Intelligencer (6/30) called use of the plan to balance the new Washington budget a "Medicaid gimmick." Columnist Donn Tibbetts of The New Hampshire News (6/30) reviewed the state's budget with the conclusion, "Some would say the budget is a house of cards including a quick Medicaid shuffle."

But adverse characterizations of bootstrap financing don't lead to avoiding it, at least from a state perspective. In Illinois, where the governor has reservations about the practice, he was under considerable pressure to adopt it both to balance the budget and satisfy health care providers. The Chicago Tribune commented (6/27) editorially, "It's foolish for Illinois to be giving up millions of dollars to which it is entitled because of disagreements over how to collect it and use it well."

The State Perspective: State officials continue to oppose restrictions on bootstrap financing. Such restrictions are considered likely to come from federal executive branch agencies soon, with an effective date when the Congressional moratorium on them ends at the end of the year.

The National Conference of State Legislators emphasized that the major factors causing escalating Medicaid costs were recession and caseload growth, federal mandates, and escalation in health care costs. NCSL's executive director indicted that "state use of provider taxes and voluntary donations is not a significant factor in the increased cost of the Medicaid program." The National Governors' Association executive director predicted that "Medicaid's role as a payor of last resort will continue to grow." The two groups and forty other national associations issued a statement encouraging federal decisions leaving states flexibility in Medicaid finance. The groups included business (NAM, U.S. Chamber), providers (hospitals, nurses), local governments (counties, cities), and labor (AFL-CIO, AFSCME).

Assessing Bootstrap Financing: There is no obvious upper limit on federal Medicaid outlays if there are no constraints whatsoever on bootstrap financing. Provider reimbursement rates could be raised with the extra income divided between the states (to use as a match and perhaps to keep some for other Medicaid financing) and the providers. Given this situation, provider rates for Medicaid could quickly rise to some benchmark, such as Medicare rates or rates charged private patients covered by health insurance. That implies an increase of 15-30% depending on the state and providers. In addition, states might well be motivated to increase eligibility for Medicaid coverage which could easily add 50-100% to participation and thus to cost. Federal officials will no doubt argue that such results are fiscally unacceptable and poor health care policy.

The broad state case for bootstrapping includes arguments like: (1) states need the money, (2) Medicaid costs are growing too rapidly so the federal effort should increase, and (3) the federal mandates are responsible for much of the increase in costs. A separate argument is that while the federal government can prescribe state matching, it shouldn't be prescribing a state's choice of which taxes to use. Many state officials feel strongly about this argument and have won some major issues, such as defeating a proposed tax treaty in the Senate over its provisions on state use of unitary treatment of corporate income.

Possible Outcomes: It seems likely that before the dispute is over, there will be consideration of compromises that reflect: (1) the federal desire for protection from unlimited cost escalation and (2) preservation of the state's taxing power. Anything considered along these lines would involve considering the continuum of bootstrap financing arrangements.

At one end of the continuum is the pure donation program designed to have absolutely no impact on state finances. In those programs, in substance, a provider such as a hospital puts money into a program voluntarily on the assurance that it will get its money back and then some. No sacrifices are involved for the state's taxpayers, other providers, patients, or any actor other than the federal taxpayer.

At the other end of the continuum is a tax on some economic activity not per se related to Medicaid reimbursement. Examples are taxes on gross receipts of hospitals, pharmacies, or nursing homes. These taxes inherently involve sacrifice on the part of a state's taxpayers, providing political controls over excessive use. Expecting federal clampdown on bootstrap financing, some states have tried to structure their programs more like these forms of taxes and less like donations.

A conceivable evolution of the Medicaid program would resemble what happened 20 years ago with another federal program when state ingenuity indicated it was nearly open-ended. This was the "Title XX" program -- Medicaid was Title XIX of the same legislation. It provided 75% federal reimbursement of social service spending. A few states, such as Illinois, were creative in qualifying many activities already taking place and using money already being spent as the 25% match. Other states began to follow, with federal costs escalating rapidly.

The result was ultimately a federal social service block grant program with a per capita ceiling set at about what the heavy participants were spending.

A Medicaid block grant isn't totally far fetched. The concept has been around since the discussions on sorting out state and federal roles in the early 1980s. Coincidentally, Hawaii, which is far ahead of other states in providing health care to a large percentage of its population, is looking for a special waiver to turn its Medicaid allocation into a block grant.

ORGANIZING PUBLIC WORKERS

Organized Labor In State And Local Government: Some trends in the economy, such as a reduction in the relative role of large manufacturing plants as employers, haven't favored labor organizations. But their popularity with state and local employees has grown, as has the number of employees, making public sector unions a major and growing force in the union movement.

Nationally, about 45% of state and local workers belong to labor organizations according to information just released by the Census Bureau shown in Table 1.

Table 1: Percentage of State And Local Workers Organized, 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	85.8%	18	Delaware	53.4%	34	Arizona	30.3%
2	New York	76.0	19	Vermont	46.2	35	Oklahoma	30.0
3	Massachusetts	75.5	20	Montana	45.9	36	Missouri	29.8
4	Connecticut	73.8	21	Utah	45.8	37	Alabama	29.2
5	Rhode Island	72.2	22	Nevada	45.4	38	Tennessee	27.7
6	Minnesota	69.8		**United States**	**45.3**	39	Wyoming	26.5
7	New Jersey	68.0	23	Illinois	45.2	40	North Carolina	24.9
8	Michigan	65.5	24	North Dakota	44.9	41	Kansas	24.1
9	Alaska	64.0	25	Ohio	43.7	42	Virginia	23.1
10	Maine	62.3	26	Iowa	39.5	43	New Mexico	22.7
11	Pennsylvania	61.0	27	Florida	38.3	44	Louisiana	22.5
12	Washington	58.6	28	Nebraska	37.2	45	Texas	21.0
13	Oregon	57.5	29	Colorado	34.2	46	Kentucky	20.8
14	Wisconsin	56.3	30	Idaho	33.5	47	Arkansas	17.9
15	Maryland	54.7	31	South Dakota	33.0	48	Georgia	15.8
16	California	54.6	32	West Virginia	31.0	49	South Carolina	15.6
17	New Hampshire	54.2	33	Indiana	30.5	50	Mississippi	8.3

Northeastern states and Hawaii show much higher percentages than Southern and Western states. This is consistent with other geographic patterns regarding organized labor, such as right-to-work laws and right-to-bargain laws for state and local government. The former are most often found in the South and West and the later in the Northeast.

State government patterns are similar to the state and local patterns shown in Table 1, but are not identical. The state data appear in Table 2.

Table 2: Percentage of State Workers Organized, 1987

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	83.1%	18	Oregon	46.5%	34	Oklahoma	20.0%
2	Hawaii	82.7	19	Delaware	42.3	35	West Virginia	19.9
3	Minnesota	81.7	20	Maryland	42.0	36	South Dakota	18.0
4	Rhode Island	81.0		**United States**	**39.7**	37	Virginia	17.6
5	New York	78.5	21	Washington	38.3	38	Louisiana	16.7
6	Massachusetts	77.0	22	Colorado	37.5	39	Wyoming	16.3
7	New Jersey	71.3	23	Illinois	35.1	40	Arizona	15.6
8	Maine	70.7	24	North Dakota	34.7	41	Arkansas	15.5
9	Alaska	68.1	25	Utah	34.0	42	New Mexico	15.4
10	Michigan	60.1	26	Nevada	32.5	43	Missouri	15.1
11	New Hampshire	58.7	27	South Carolina	31.1	44	Nebraska	14.3
12	Pennsylvania	54.9	28	Tennessee	29.2	45	Texas	14.1
13	Montana	54.0	29	Idaho	29.0	46	Indiana	12.1
14	Wisconsin	49.1	30	North Carolina	22.9	47	Kansas	11.3
15	Ohio	47.9	31	Georgia	21.8	48	Florida	10.7
16	Vermont	47.8	32	Iowa	21.7	49	Mississippi	9.1
17	California	47.3	33	Alabama	21.2	50	Kentucky	2.1

The typical pattern is for a higher percentage of local employees to be organized than state employees. As a result, the state and local percentage organized (Table 1) exceeds the state employee percentage (Table 2) by 5.6% nationwide. In extreme cases -- Florida, Nebraska, and Washington -- the spread is over 20%. In some states, the percentage of state workers organized is higher than that of state and local workers combined, particularly in South Carolina (15.5% more state), Minnesota (11.9%), and Connecticut (9.3%).

MISCELLANY

Bridgeport Bankruptcy: The federal judge with jurisdiction over Bridgeport's attempt to obtain bankruptcy protection has rejected the contention of the State of Connecticut that the city has no authority to file for bankruptcy. The decision rests on Connecticut law on the powers of municipal corporations. For other states, particularly home rule states, it suggests that if state officials want to preclude local bankruptcy filings their laws should say so explicitly. The next issue for the court is whether the city is really insolvent.

Budget-Balancing Devices: New York's comptroller has been particularly critical of this year's state budget agreement -- in the process coining two new terms for fiscal practices he doesn't like. It is common for fiscal authorities to be concerned about funding ongoing expenditures with one-time measures such as revenue acceleration, spending delays, and sale of assets. Comptroller Regain has been critical of the device of using the Thruway Authority bonding power to fund grants to New York local governments, which he calls "a sophisticated, albeit presumably legal, money laundering scheme." But the practice could be followed year after year, so he calls it a "recurring one shot." He is also critical of the tendency of the New York legislature (and other legislatures) to resolve difficult end-of-session issues by appointing commissions to deal with them. He calls these "Let's Adjourn commissions designed to allow legislators to say something has been done so they can get out of Albany."

Farm Property Values And Taxes: The farm financing crisis of the early 1980s appears to be over. As farm prices dropped from a national average of $689 per acre in 1984 to $513 in 1986, some farmers found they could neither make their mortgage payments nor get out from under by selling their mortgaged land. Some states established special programs to try to help them. Since 1986, farmland prices have been relatively stable, so there is little discussion of the state programs.

The federal government spends large sums gathering detailed data about agriculture including an annual series on farmland and buildings by state. Not surprisingly, farmland with rich soil, proximity to markets, and plenty of water goes at a higher price than other farmland, particularly when conversion to urban uses is possible. In 1991, an average acre in New Jersey was worth just over $4,000. Corn belt land in states like Illinois and Iowa was about $1,000. The best buys are in Wyoming, where land averages $131 an acre, or Nevada at $168. Farmers in these states own lots of acres. The average Nevada farm is worth $779,640 versus $314,427 nationwide.

One aspect of these data of particular interest is a comparison of the taxes paid on farm acreage to the market value of the property. Budget constraints have eliminated the prospect of getting this information from the Census Bureau, so the farm survey is the only choice. Because states differ in the taxes they apply to farms versus other kinds of property, the farm tax burdens are not a proxy for tax burdens generally. Table 3 shows the taxes on farm property as a percent of value in 1989.

Table 3: Farm Property Taxes As Percent Of Market Value, 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Michigan	3.29%	17	Ohio	0.75%	34	North Carolina	0.44%
2	Arizona	1.97	18	Massachusetts	0.70	35	Maryland	0.40
3	Wisconsin	1.96	19	North Dakota	0.65	35	Tennessee	0.40
4	New York	1.79	20	Hawaii	0.63	35	Utah	0.40
5	Nebraska	1.27	21	Colorado	0.62	38	Arkansas	0.37
6	Illinois	1.15	21	Idaho	0.62	39	Missouri	0.36
7	Vermont	1.13	21	Washington	0.62	40	Oklahoma	0.35
8	Iowa	1.02	24	Indiana	0.60	41	South Carolina	0.34
9	South Dakota	0.97	24	Montana	0.60	42	Mississippi	0.30
10	Oregon	0.96	26	Kansas	0.59	43	Nevada	0.29
10	Rhode Island	0.96	27	Florida	0.58	44	Kentucky	0.26
12	Maine	0.86	28	California	0.57	44	Louisiana	0.26
12	Pennsylvania	0.86	29	Connecticut	0.56	46	New Mexico	0.22
14	New Hampshire	0.85	30	Georgia	0.53	47	Alabama	0.16
15	Minnesota	0.82	31	Texas	0.49	48	West Virginia	0.15
16	New Jersey	0.81	31	Virginia	0.49	49	Delaware	0.07
	United States	**0.76**	33	Wyoming	0.48	50	Alaska	n.a

There is a reasonably close, but not perfect, correlation between high property tax burdens shown in Table 3 and high property taxes by other measures such as property tax effort (States In Profile, Table D-21) and property taxes as a percentage of personal income (D-9). The lowest taxes are in Southern and Southwestern states. The highest are in the Midwest and Northeast, particularly New York.

Housing Starts: Home builders are complaining with increasing intensity that their industry is being devastated by multiple factors. The recession hurts overall demand for new homes. Restrictions on timber cutting drive up prices, perhaps as much as $3,000 a house. And restrictions on bank lending and banker caution dry up credit. For whatever reason, nationwide starts through May this year are down 28% from the same period a year ago. The change in selected states shown in Table 4 provides evidence that the one-year change is highly unevenly distributed.

At least three factors are affecting the state-by-state results. First is the overall health of a state's economy, with the Western states doing comparatively well. Second is whether the local housing market was already depressed in 1990, so it didn't have far to fall. This is why some of the Midwestern states and Arizona beat the national average. Third, the reverse of the second, is whether the local economy had been booming -- the bigger they are, the harder they fall. This is part of the explanation in California and Nevada, which still have high levels of housing starts relative to population.

Sharp declines in housing starts and other construction cascade through a state's economy because many other purchases are associated with construction and moves into new homes and offices.

Table 4: Percent Change In Housing Starts Through May, 1990-1991

State	Percent	State	Percent	State	Percent
Utah	22%	New York	-23%	Nevada	-32%
Colorado	16	Ohio	-25	Florida	-34
Texas	-8	Connecticut	-28	Oregon	-37
Pennsylvania	-15	**United States**	**-28**	Maryland	-38
Arizona	-16	Virginia	-30	Washington	-40
Georgia	-18	Illinois	-31	California	-46
Michigan	-22	Massachusetts	-31	New Jersey	-52

Kudos: Utah's economic development gets favorable reviews from Time (7/29) with the quality and low cost of the workforce considered the key to its success. Forbes (8/5) celebrates the achievements of "forceful young" Governor Weld in "The Boston Supply-Side Party." It likes repealing the sales tax on professional services, cutting the budget, blocking universal health insurance, closing mental health institutions, and the new R&D credit in the corporate income tax. The unknowns are whether the FY 1983 budget can be balanced given the one-time items used to balance FY 1992 and whether the governor can, "as promised, save money by running government more efficiently."

The 45 best hospitals in America are selected by U.S. News (8/5). Practically all of those selected are private, not-for-profit ones -- excluding profit-oriented hospitals, local government hospitals, and state-affiliated hospitals. The local and/or state-affiliated hospitals among the 45 include five in California: four associated with California state universities and one with Los Angeles County and the University of Southern California. The others are the hospitals associated with flagship state universities in Iowa, Michigan, Texas, and Washington.

USA Today (7/17) got responses from 37 governors to a request to pick five of their colleagues "who have done the most for education in their states." Winners: Campbell (SC), Clinton (AR), Gardner (WA), Romer (CO), and Wilkinson (KY). Other results suggested preferences for providing more social services through the schools, less rigid teacher certification requirements, and more choice of schools for students and their parents. Governor Gardner's education leadership appeared more prized nationally than at home as the Washington legislature failed to adopt his education reform proposals in a recent special session. Governor's aides blamed partisan politics for the defeat. Opponents blamed the plan.

It's kudos of a sort -- New York's governor has offered political asylum to Connecticut's governor who is associated with the proposed new income tax, closing down state government, and inability of the state's elected officials to resolve the state's tax policy and fiscal plan. Governor Weicker has a few quips of his own including, "Nobody every told me this job would be easy, and nobody lied." Also kudos of a sort: when Weicker went on television in mid-July to explain the need for an income tax, his ratings matched such popular programs as Jeopardy and Entertainment Tonight.

Texas Governor Richards was booed and the target of a few thrown beer cans at a Fourth of July event. The problem probably had nothing to do with public policy. A city council member in Austin, where the incident occurred, commented: "I would never, as a political figure, get up and give a speech in front of a crowd that had been drinking beer for eight hours, listening to a rock concert and waiting for fireworks."

New Laws: July 1 was the effective date for most new state laws. Many of the new taxes took effect on different dates, basically as soon after passage as possible. So quick-acting states started collecting new revenues in FY 1991 while slow-acting states used effective dates like July 15 and August 1. Many of the income tax increases are retroactive to January.

Not all subjects were equally weighty. Arkansas made the square dance the official state dance. It is now illegal to let thistle go to seed in Boone County, but apparently OK in other Arkansas counties. Henceforth in North Dakota, those who advertise buttered popcorn will have to use real butter. In Idaho, the hallucinogenic drug peyote can now be legally transported, but only for use in religious ceremonies and only by members of the Native American Church. Arkansas opted to exempt sales of Christmas trees from the sales tax, while raising the fee for sellers of contraceptives.

For some reason lost in history, New Jersey has been giving local school superintendents lifetime tenure, like college professors. The good news for local school boards is that the state will join 49 others in not requiring this. The bad news is that the state will require they give long term contracts. Kansas has a new mandate of kindergarten programs. All districts have them but advocates sought and got state help to prevent them from being cut back.

Not all the Texas legislation made it into law. Governor Richards vetoed 36 bills so far this year. Some of the topics: expelling students for having knives, limiting witness fees, private club liquor licenses, boll weevil eradication, and exempting "street rod" vehicles from state vehicle inspections.

New Workweek: Maryland employees will shift from a 35.5 hour workweek to 40 hours after employee unions failed to obtain a court order to prevent the governor from implementing the decision. Maryland was one of only a few states that have standard weeks of less than 37.5 hours.

Productivity And Infrastructure: The idea that slumps in private sector productivity growth are caused by underinvestment in public sector infrastructure is appearing frequently in state debates on public works spending and federal debates on increasing gasoline taxes. There is considerable controversy among academics (see Technical Notes) about whether there is evidence of any relationship. While there has been some interest in the concept in some states, it doesn't seem to have triggered major changes in policy.

Retirement And Taxes: Retirees are a major development plum for states that attract them. They contribute substantial taxes and purchasing power while making minimal demands on public services. Money (July) assesses the tax climate of ten leading retirement states and concludes, "Retire to Florida, Not California." For its typical couple with a retirement income of about $35,000, state and local taxes range from $1,634 in Florida to $3,718 in California.

Much more than comparable calculations for mobile business executives, the retiree tax calculation is highly subject to assumptions about the household. What portion of income comes from Social Security, public pensions, private pensions, interest and dividends, and capital gains matters considerably. So does the local community into which a retired person moves. One factor that is uniform statewide is whether the state adds an estate or inheritance tax to federal taxes. Most states don't but some, like New York and Pennsylvania, do. Repealing the Massachusetts one is part of the governor's agenda for improving the state's economic climate.

Sales Tax Base Broadening: It has been a mixed year for the concept of broadening the base of the sales tax. The concept is popular with executive and legislative staffs almost everywhere, so it was automatically on the agenda for any state considering raising revenue. In some cases, such as California and Maryland, it has been on governor's agendas. In others, like Texas, it emerges from special reports of study commissions and legislatively generated alternatives. In yet others, some proposals appear for the first time in conference committee deliberations, as happened in Ohio.

Quantitative returns aren't in yet, but it appears that many states will show significant revenue from base broadening. All will be incremental, adding a few items, rather than sweeping.

The most sweeping proposals were made by the governor of Kansas (rejected but she's not quitting) and as alternatives to income tax proposals in Connecticut and Texas, where decisions haven't been made. There were two setbacks. Massachusetts repealed its tax on professional services which was in effect only for a day. New Jersey repealed two components of its broadened tax base: (1) trucks and truck parts because Garden State firms were losing business to other states and (2) paper products because of voter resistance. Taxing toilet paper became the symbol of tax resistance.

The National Association of State Budget Officers (444 North Capitol St., NW, Washington, DC 2001) has released a 16-page review, The Revenue Potential Of Taxing Services. Using data from Georgia, New Mexico, and Tennessee, the study shows that services are rising as a portion of economic activity and that the growth is partly captured by broad-based service taxes (New Mexico). However, from 1980 to 1990, all three states experienced a reduction in the ratio of taxable sales to personal income. The report concludes:

> States are currently in a situation where their tax systems cannot generate adequate resources to fund ongoing services. In a slow economy, states must consider all available options for both taxing fairly and providing essential services. Expanding the sales tax base to include services, and putting the service sector on even footing with the goods-producing sector, would be a positive first step.

States With No Budgets: State Budget & Tax News counted nine states without enacted budgets at the July 1 beginning of the year: California, Connecticut, Illinois, Louisiana, Maine, Massachusetts, North Carolina, Ohio, and Pennsylvania. In addition, states with late-beginning fiscal years -- Alabama (Oct.), Michigan (Oct.), and Texas (Sept.) -- didn't have FY 1992 budgets. Most of these states resolved outstanding issues in July with little or no disruption of state activity. Most, like Ohio, had experience in running into the new fiscal year and had adequate cash to manage the situation. The primary exception was Maine which had nationally publicized disruptions.

This left five states without budgets including the three that aren't yet at the beginning of their fiscal years. In Connecticut and Pennsylvania, there were substantial disruptions including missed payrolls in Pennsylvania and closed state facilities, including parks on the July fourth weekend, in Connecticut. In each of these cases, temporary appropriations (continuing resolutions) have become a bargaining chip in the substantive negotiations.

TECHNICAL NOTES

Clawing And Scratching For Development: The numbers associated with big-deal economic development investments are always in dispute. Those used in the article should be viewed as order of magnitude, and not closely comparable from deal to deal. In every case, there are four critical variables beyond unknowns associated with the investment itself, like how many people will be hired. They are: (1) the rate of interest used to discount costs to present value, (2) the extent to which new employees come from out-of-state, (3) the number of secondary jobs, the multiplier, and (4) the extent to which investments, like providing roads to a plant site, are viewed as part of an incentive package versus normal state programming. Different assumptions are made from state to state and even within a state. In Colorado, for example, analyses by proponents of the larger United deal and a legislative staff analysis showed different cost-benefit results largely because of differences in the second assumption.

Reports had no reason for singling out Oregon as an example of this year's legislative activity other than its Joint Legislative Committee on Trade and Economic Development (State Capitol, Room 132, Salem, OR 97310) sent its summary of 1991 Major Economic Development Legislation about the time the development article was being written. The third edition of NADA's efforts is Directory Of Incentives For Business Investment And Development In the United States: A State-By-State Guide (Urban Institute, 1991).

Miscellany: Farm property information, including taxes, is from the U.S. Department of Agriculture's Agricultural Resources: Situation And Outlook Report (June 1991). Housing start information is collected by the Census Bureau and published in the Current Construction Reports series. The National Association of Home Builders calculates change rates in Housing Economics (July 1991).

The data on organized labor in state and local governments comes from the 1987 Census of Governments: Volume 3: Public Employment: Number 3: Labor-Management Relations published in June 1991.

The most recent criticism of the concept that public infrastructure promotes major improvements in private productivity appears in articles in the Federal Reserve Bank Of St. Louis Review (March/April and May/June) by John Tatom of the bank's staff. The case for the concept appears in articles by David Aschauer and others that are cited by Tatom. The subject is covered in a 250-page book, Is There A Shortfall In Public Capital Investment? published by the Federal Reserve Bank of Boston and edited by Alicia Munnell of the bank.

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All but a few states have completed their fiscal action for the year. The situation should be better next year, but there are several troublesome problems affecting the outlook.

- State Financial Outlook p. 2

The clash of adamant no-new-tax stands with apparently growing reasons for tax increases was conspicuous in the Midwest this year. The issues were national in scope. The outcomes varied.

- State Policy In The Industrial Midwest p. 5

State insurance regulators are facing major problems with insolvent insurance companies. California and New Jersey have assumed control of companies with policyholders nationwide.

- Insurance Solvency Regulation p. 9

The Texas legislature has acted to implement many ideas of a 1,000 page report on cost cutting. It has recommendations that may be followed in other states.

- Money-Saving Ideas p. 11

This year produced a potpourri of policy issues associated with taxing health care and other providers, production equipment, "free" goods, and mail-order sales. Also at issue: earmarked taxes and ending sales tax exemptions.

- Tax Policy Issues p. 14

Miscellany deals with air wars, Bridgeport's bankruptcy, Medicaid financing, gambling, health plans, state and local finances, states without budgets, Governor Snelling, and federal grant reform. Technical notes indicate data sources.

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August 1991 (Second of Two August Issues)

STATE FINANCIAL OUTLOOK

Introduction: State legislatures have just concluded the most active budget sessions in decades. They were active as measured by tax increases, time devoted to fiscal subjects, and extent to which policies affecting all departments and functions were controlled by fiscal considerations. Everywhere the next question is the same: Will the actions taken in 1991 solve the problems, or is another round of difficult fiscal politics coming next year?

Status of 1991 Actions: By late August, all but two legislatures had acted on budgets for FY 1992.

One exception was Connecticut where the legislature has passed three budgets only to see them vetoed. Parks and offices closed in July, as continuing resolutions to keep them open themselves became a subject of controversy. The major issue remains whether to adopt a personal income tax, as the governor proposes, or try to get along without one. The three budget and tax bills avoided an income tax by increases in the sales tax rate, or sales tax base, or both. They included other revenue-raising measures and financing changes, including one-time measures which the governor argues would cause continuing financial crises. The last measure to be vetoed had 128 different revenue-raising provisions.

The other exception is Michigan where the new fiscal year doesn't begin until October 1. The potential for stalemate is great, as indicated by the fact that it took until this summer to resolve adjustments to the current year budget. Newly elected Governor Engler (R) has been pushing for no tax increases, a local property tax limit, and sharp spending cuts to make the first two possible. Many of the spending cuts have produced extensive opposition in and out of the legislature. A tentative leadership agreement sets spending increases at about the inflation rate and avoids tax increases, but only by such potentially controversial measures as selling the state liquor stores and eliminating $45 million of revenue-sharing with local governments.

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While legislative consideration of the budget is basically complete in the other states, many legislatures have work left to do. There have been substantial gubernatorial vetoes for legislative consideration in such states as Alabama, Illinois, Minnesota, Ohio, and Wisconsin. Legislative reconsideration of aspects of the budget bills that were recently passed is expected in California. A special session to reopen tax issues could take place in Tennessee.

Voter approval is needed to finish the budget process in Missouri, where tax measures are on the ballot in November. Several states have lottery votes. Miscellaneous budget-related measures have been or will soon be on the ballot elsewhere, such as the August Texas vote on property tax exemption procedures that are associated with the revision in school finance by the state.

Summary Of The FY 1992 Budget Actions: The preliminary fiscal survey released by the National Conference of State Legislatures in mid-August reflects the fiscal problems and tax increases observers have been reporting since spring. Spending is budgeted to rise at 4.2%, about the inflation rate. Revenues, fueled by tax increases, will grow about 8.3%. The difference will restore balances somewhat, to a projected level of 2.6% of spending up from 1.9% at the beginning of the year.

When all the returns are in, including states not in the NCSL survey, the state tax increases will likely fall in the $16-20 billion range. This is the largest tax increase ever and the largest as a percentage of state budgets since 1971. As previously reported, the increases weren't concentrated on any one tax source. Personal income, sales tax rates, sales tax base, corporate income, gasoline, cigarettes, and more were all reached.

The Outlook: In releasing the survey, NCSL commented, "the depressed condition of state finances is likely to continue." How bad next year's situation might be depends on several factors, particularly: (1) revenue prospects affected by the national economic outlook, (2) revenue affected by federal Medicaid reimbursement policy, (3) how much spending exceeds estimates, and (4) how deep a hole officials of some states may have dug for themselves. As usual, there are also factors unique to some individual states -- school finance cases, Oregon's property tax limit, Nebraska's property tax discrimination problems, etc.

Revenue And The National Economy: National economic performance is the major unknown in assessing the state fiscal outlook. State estimates, like federal ones, presume economic recovery in FY 1992 with an annual economic growth rate (real GNP) of about 3%. It is possible that this rate will not be realized or that revenues won't perform as anticipated because of taxpayer behavior -- such as buying more untaxed services and less taxed goods. Individual state economies may perform worse (or better) than anticipated even with a correctly anticipated national economic climate.

Preliminary results aren't encouraging. There have already been revenue shortfalls and sometimes cutbacks in Florida, Georgia, Idaho, Maryland, Missouri, Montana, and probably other states. On the other hand, some states such as Massachusetts are reporting more favorable revenue results than anticipated.

Revenue And Medicaid Reimbursement: As discussed elsewhere in this issue, the states are in imminent danger of losing expected federal Medicaid reimbursements. These revenues are a part of the revenues anticipated for this fiscal year and beyond in state fiscal plans. Their loss would force reconsideration of fiscal plans and enacted budgets. The options are: (1) replacing the revenue by new tax measures, (2) cutting Medicaid spending, (3) cutting other spending, (4) searching for more one-time measures, and (5) combinations of these.

Spending Underestimates: Again in FY 1991, states spent massively more for Medicaid and corrections than legislatures appropriated when the budgets were initially enacted. The NCSL survey shows a 23% increase for Medicaid and a 17.6% increase for corrections. The overruns are again possible in FY 1992, putting an added strain on state budgets. In addition, massive amounts of contingent liability are being built up in litigation by provider groups, particularly hospitals, on Medicaid reimbursement rates.

How Deep A Hole? Most state budgets carry some sort of fiscal momentum into the ensuing fiscal year, making the next budget tighter or more flexible than the last. In an ideal world this wouldn't happen. Instead, a multi-year spending and revenue plan would ensure that one year's patterns could be sustained in the next without building in either tax cuts or tax increases. But sometimes state officials take a one-year view of solving fiscal problems and leave problems for the following year. Conversely it is possible, by design or misestimates of revenue and/or spending, to build unexpected surpluses. The individual states don't seem to have acted consistently in this dimension of fiscal policymaking.

According to the NCSL survey, states will take in more revenue in FY 1992 than they will spend. If it happens, this will build up balances and leave a situation where revenue growth can be devoted to spending growth in FY 1993. In fact, running a surplus in FY 1992 means part of the revenue growth that builds balances in FY 1992 can fund spending in FY 1993. In other words, the NCSL figures indicate the reverse of high reliance on running down balances to manage the current fiscal year.

But the situation isn't likely to be as sanguine as those survey numbers suggest. Part of the problem is that many of the revenues are one-time ones. They include the sale of a highway to the turnpike authority in New Jersey and the sale of state property in Massachusetts. They include one-time acceleration of tax and non-tax revenues in many states. Reported spending is lower because some local aid spending has been shifted from one fiscal year to the next, creating a one-time pickup in FY 1992. Natural revenue growth in FY 1993 will have to pick up permanent financing of such one time items, leaving less revenue from existing taxes to finance normal spending growth.

Some of the state budget packages were designed to be clearly sustainable in future years without tax increases. Examples are California, Pennsylvania, and Vermont. Other states have clearly built in problems for the future. Examples are Illinois, New Jersey, and Tennessee, probably to be joined by Michigan.

Summary Outlook: The state fiscal outlooks are closely tied to what happens in the national economy. A national growth rate 3% below what state officials expected caused much of the difficulty experienced this year. State officials are expecting about 3% national growth again. If they get a disappointing 0% again, there will be problems next year like those this year. Conversely, if they get 6% or unanticipated inflation, the short-term state fiscal condition would improve markedly.

Without any surprises on the economic front, state finances in 1992 are likely to be tight, though not as tight as 1991. New initiatives will be scarce. Tax cuts will be rare, and many "temporary" enactments this year probably won't be allowed to expire on schedule next year. Besides the economy, the biggest threat will be Medicaid -- both because of potential revenue loss from federal regulations and because of higher-than-anticipated spending. This kind of tight outlook could be a pattern, affecting not just 1992 but most of the decade of the 1990s.

If this is to be the pattern, the actions of 1991 in the Industrial Midwest provide examples of what could be happening in most of the states.

STATE POLICY IN THE INDUSTRIAL MIDWEST

Introduction: In 1991, the Industrial Midwestern States provided important examples of fiscal politics and policy. In broad terms, states this year were in three fiscal situations. In one group, such as the Northeast and California, tax hikes were almost inevitable without radical changes in state policy. In another group, mostly west of the Mississippi, tax hikes were clearly avoidable and generally avoided. A third group, dominated by the Industrial Midwest, was right at the margin.

Economic Condition: The good news for the Industrial Midwest is that the recession wasn't devastating. Most recessions have hit this region harder than other parts of the country. Manufacturing has been disproportionately hit by job losses which have echoed throughout the economies of communities like Cleveland, Detroit, Gary, Milwaukee, Pittsburgh, and the Quad Cities (in Illinois and Iowa).

Reduced reliance on manufacturing, reflecting a national pattern, reduced Midwestern vulnerability to manufacturing downturns. This recession has had heavy impacts on financial services, housing construction, and defense contracting, not heavily concentrated in the region. Meanwhile, exports and agriculture have fared reasonably well to the advantage of the region. The recent rates of employment change and population of the region's states are shown in Table 1.

Table 1: Population (million) In 1990 and Employment Change (March 1990-1991) Industrial Midwestern States

State	Population	Employment Change Percent	Employment Change Rank
Illinois	11.5	0.1%	29
Indiana	5.6	-0.1	32
Iowa	2.8	1.4	18
Michigan	9.3	-2.9	45
Minnesota	4.4	0.0	31
Ohio	10.9	0.4	27
Wisconsin	4.9	0.8	24
Total/Average	49.4	-0.0	29
United States	**249.0**	**-0.1**	**n.a.**

The region lost 0.04% of its jobs while the national loss was nearly identical. The average rank in job loss was 29, but because the most populous states had the greatest unemployment loss, the national average was exceeded by 32 states. Only Michigan's employment decline was serious enough to place it in the 15 states with the most problems.

Politics: The political patterns of these states are quite similar. Four have newly elected Republican governors who campaigned on themes of economy, efficiency, and no new taxes. Two -- Iowa and Wisconsin -- have veteran Republican governors pushing the same policies. The lone Democrat, Governor Bayh of Indiana, has consistently argued for no new taxes. Democrats control the House in all seven states. Republicans control the Senate in Indiana, Michigan, and Ohio. As a result, party control is divided in each of these states.

Difficulties In Setting A Budget: Two factors associated nationally with difficulties in reaching budget conclusions this year were tight fiscal circumstances and divided party control of state government. These seven states had both. Stalemates of one kind or another caused most of them to be off schedule in their budget deliberations. Michigan had tardy adjustment of FY 1991 finances and may have difficulty in enacting a new budget by the October 1 beginning of the fiscal year. Illinois and Ohio didn't complete budget enactment until after July 1. Substantial fiscal issues were being resolved after July 1 through the veto process in Minnesota and Wisconsin. Indiana finished on schedule, but only after the regular session failed to reach agreement and special sessions were called. Only Iowa finished on schedule without special problems.

Small Tax Increases: The Midwestern governors' budgets called for no new taxes and substantial cuts, management changes, and reorganizations. In general, the budgets returned by the legislatures have less management change and more taxes than the governors' budgets. There was no increase in the rates of a major tax, except Minnesota's sales and income tax increase. But there were several close calls including serious consideration of a sales tax increase in Iowa and legislative passage of several tax increases in Wisconsin.

Illinois extended its 1989 income tax increase that was scheduled to expire and raised revenue by converting a property tax deduction to a credit. Indiana raised motor vehicle taxes that recently had been lowered. Iowa raised the cigarette and real property transfer taxes. The returns aren't final from Michigan but the local betting is against tax increases. Minnesota has increased its sales tax and broadened the base, though the tax increase is arguably a new local tax. Ohio extended the sales tax to some services. Wisconsin's legislature passed extensive tax increases that the governor has vetoed.

Other Revenue Increases: Medicaid bootstrap financing found its way into most of the seven state budgets, though the use of the device is probably less significant as a percentage of revenue than in Southern states. The other sources of non-tax revenue, such as tuition increases, were used extensively by Midwestern states just as they were throughout the nation.

One Time Measures: There was greater-than-normal use of one-time measures in these states' budgets. In Illinois, nearly half a billion is being borrowed through a state revenue bond agency to pay health care provider bills. Illinois also adopted a one-month delay in payments to school districts. Michigan leaders have tentatively approved a one-year moratorium on local government revenue sharing. Sales tax payments to the state from vendors are accelerated in Illinois and estate tax payments are likely to be accelerated in Michigan. Indiana is drawing down its balances to finance the new budget.

Spending Priorities: The no-new-tax approach taken in the seven states' budgets placed a premium on increases that seemed unavoidable, generally Medicaid and corrections. While the results are somewhat obscured in some of the budgets because of underestimates and migration of costs among fiscal years, the Ohio budget summarized in Table 2 is indicative of the pattern which will appear as the budgets are implemented.

Table 2: Increase in Ohio FY 1992 Appropriations ($ million)

Category	Dollar Increase	Percent Change	Percent of Increase
E&S Education	$62	2.1%	8.1%
Higher Education	30	1.8	3.9
Medicaid	466	14.1	60.7
Welfare (AFDC)	48	5.5	6.2
Corrections	52	10.8	6.8
All Other Programs	110	3.4	14.3
Total	768	6.1	100.0

The head of the conference committee called it a "hold-harmless, hold-the-line, minimum budget." Ohio generated a nearly no-new-tax budget, but only by holding spending growth to 6.1% or barely above inflation. Within this total, it accommodated a 14% increase in Medicaid and an 11% increase in corrections plus a caseload-driven welfare increase that was about the same percentage as the increase in the total budget. These increases ate up 74% of all the new money -- 61% for Medicaid alone. The result was increases below the rate of inflation in the other categories of the budget, particularly education.

The Outlook: Many of the states based their budget decisions this year on making sure that tax increases would not be again required in the foreseeable future. The Midwestern (and most Southern) budgets don't have this characteristic. Instead the same issues can be expected to be back in 1992, including the same debates over tax increases.

INSURANCE SOLVENCY REGULATION

State Regulation In The News: The public has been seeing state regulation at work as several large insurance companies failed. Major companies, insuring hundreds of thousands of people, have been thrown into state receivership. Some annuity holders have lost money. There are widespread fears that more losses may be on the way.

Insurance v. Other Financial Regulation: State and federal roles in regulating financial institutions aren't well understood. The underlying responsibility for regulation of any institution that holds other people's money is that of the government that charters the institution -- that permits it to operate. Thus, how much to regulate and whether to regulate has been a state decision for banks, savings and loans, credit unions, insurance companies, prepaid life care communities, health spas, prepaid funeral plans, cemeteries, and other business that take money first and promise to deliver later. There is always a risk that, by poor management or theft, such institutions will take money but not deliver later.

Over the decades, the federal government has opted to charter some institutions in these categories including national banks, nationally chartered savings and loans, and some credit unions, but not insurance companies. These nationally chartered institutions are exempt from most state regulation but are subject to federal regulation.

The dynamics of regulation gradually changed with Depression-born federal deposit insurance. The federal deposit insurance agencies could regulate insured institutions, but not all were insured. To make a long story short, many of the federally insured institutions failed, including many chartered and regulated by the states. At the same time, those states that opted to let some institutions operate without federal insurance began to experience failures as well, with nine-digit losses to state taxpayers in Maryland, Ohio, and most recently Rhode Island.

Insurance Regulation: There is no federal deposit insurance program for insurance companies, nor are they subject to federal regulation of rates or policy terms. Each state charters and licenses insurance sales within its borders. For multi-state companies, this creates complex supervisory arrangements among states.

State regulators are attempting to ensure that insurance companies don't fail. That is, that they have sufficient money to pay off all policyholders what they are due when it is due. To this end, state regulators have procedures, similar to those that failed with S&Ls and banks, to make sure assets exceed liabilities.

Gaps In Regulation: For complex reasons involving state and federal policy, there are some acknowledged gaps in insurance regulation. One is reinsurance, the business of insuring another insurance company for part of its loss exposure. Many reinsurers are offshore companies, not subject to the direct regulation of any state. Another gap is business taking the legal form of self-insurance by business associations.

Insurance Guarantee Funds: All but a couple of states have backup arrangements to pay off claimants of failed insurance companies by assessments against other companies operating in the state. These are similar to the federal deposit insurance arrangements with two important exceptions. First, in most cases the states don't actually hold the money in a fund. When money is needed there is an assessment against solvent companies. Second, some states indirectly require taxpayers, not insurance companies and their customers, to pay all or part of the assessments. The insurance companies' payments of assessments become credits against the insurance premiums tax.

There are limits to the coverage: (1) limits on dollar amounts, (2) excluded coverage such as guaranteed investment contracts and municipal bond insurance, and (3) perceived inability of the funds to pay. For example, Time (8/5) told its millions of readers that the state plans "may not be enough if a large insurance firm goes under." USA Today (7/16) headlined, "Some States' Insurance Safety Nets Precarious." It cited: (1) no coverage in the District of Columbia and Louisiana, (2) limits on coverage such as $300,000 per person, (3) no non-resident coverage, and (4) delays in payments.

Executive Life: California regulators recently announced they approved turning over Executive Life to two French investment groups. There will be policyholder losses, as many will get only 81 cents on the dollar and won't necessarily get their 81 cents on schedule. Many policyholders will have the difference covered by their state insurance funds. Customers who try to redeem policies will face a special penalty of 10% levied by the State of California. There are several complications that could cause the deal to come unstuck, including a major IRS claim and litigation by holders of guaranteed investment contracts. These GICs arguably aren't insurance and holders won't get the same recovery.

Mutual Benefit Life: New Jersey regulators took over Mutual Benefit Life, but the state was one of the few without a guarantee fund. So one was passed this summer. Besides Mutual Benefit, the legislature was responding to a threat that New Jersey Blue Cross would lose its certification from the National Blue Cross-Blue Shield Association. It was concerned that with no state fund, New Jersey could produce a situation parallel to West Virginia, also without a fund. West Virginia Blue Cross went bankrupt without coverage.

Acting to preserve policyholder assets, New Jersey regulators placed a moratorium on policy loans and honoring guarantees of over $600 million of municipal bond issues by the company.

Federal Regulation? A new round of proposals has surfaced in the Congress to shift major portions of insurance regulation from the states to the federal government. State insurance commissioners oppose the move. There have been hearings on the subject for the past several years, but no sign of movement of the legislation.

MONEY-SAVING IDEAS

Introduction: Every year there are dozens of reports about how to improve the efficiency of state government. Some are privately commissioned by groups like state chambers of commerce or leagues of women voters. Some are informal reports by task forces in the executive branch and special committees in the legislature. A few are the work of blue ribbon groups. Some are quite expensive. Connecticut spent $4 million for its reports. Most don't have much impact.

Texas Performance Review: The Texas report, Breaking The Mold: New Ways To Govern Texas, may prove to be an exception. Its timing was definitely right. The Texas Performance Review (TPR) report was presented in late June just before a legislative session faced with a budget gap of about $5 billion. Conveniently, this was about the savings over the biennium that were offered by the report. Not all the recommendations were money saving but would, in the words of the covering letter, "help transform state government into a 21st century organization committed to quality consumer service." The governor found many of these recommendations, such as substituting single agency heads for boards and commissions, to her liking. She has been pushing them along with the report's other recommendations. There was an atmosphere in the legislature that the recommendations should pass unless there were compelling recommendations for rejecting them.

The report sees a structural deficit in state finances as indicated by the current service budget estimates for the biennium. The spending levels increase 33% from FY 1990 to FY 1993 while personal income growth is expected to be only 20% and revenue will lag behind both at 17%. The recommendations to deal with the situation consume 1,000 pages. The ones that may be of most interest to readers are highlighted in this article.

Consolidating Small School Districts: Texas has had incentives for the maintenance of small districts in its state aid law. One, the "small district adjustment," is already scheduled to be phased out. TPR suggests limiting administrative reimbursements which would affect extraordinarily small districts as well as some high-spending ones. A state aid increase is recommended for aid for districts that consolidate.

Vocational Education: The report finds over 40% of vocational education programs "are in areas of no demand, gross oversupply, or both" and recommends limits on state reimbursement.

Tuition: Higher tuition reflects a major share of the total gap-closing recommendations of TPR, just as it did of the actions of many states this year. The report recognizes the extent to which the enrollment-limiting aspects of tuition, particularly out-of-state tuition, are limited by tuition waivers and suggests they be limited. In FY 1990, 19% of non-resident Texas students received waivers, including 57% at West Texas State.

Medical Education: State appropriations per student in FY 1991 were $4,271 for general academic institutions but $18,185 for nursing students, $48,051 for dental students, and $62,282 for medical students. The report makes several suggestions for cutting these costs, including taking into account some of the patient revenues earned by state university medical centers.

"Special Needs Offenders": The prison population is aging in Texas and elsewhere. Texas prisons now house over 500 inmates over age 60, about 750 impaired by mental illness, and more than 3,200 with an IQ below 70. TPR suggests that at least 2,000 beds could be freed for violent inmates by putting some of these individuals into community care or other settings. In the process, their eligibility for Social Security, Medicaid, and Medicare would be increased, further reducing state costs.

Management Versus Cost-Saving: There is a continuing dilemma in the packaging of efficiency recommendations. Management reports, like those done by loaned executives and consulting firms, often endorse management moves, such as consolidating smaller agencies or replacing multi-headed agencies with a single accountable agency head. Such moves don't normally save money in the short run. In fact, they have extra expenses for office moves and transition measures.

Often on a different track entirely are the budget-balancing moves that have no particular claim to management excellence. Some of these are generally agreed to be poor management, misleading accounting or both. Paying bills late is an example. Other budget-balancing moves just shift costs to someone else such as university students through tuition. The people who write management improvement reports are reluctant to endorse these as good management recommendations.

Sometimes elected officials try to sell the management improvements as likely to save large sums of money. **Reports** recalls examples in Iowa and Mississippi. Some claims along these lines are likely to be made in New Jersey. There are some difficulties with this approach including trying to explain why if money is being saved, the budget for the affected functions must rise.

Combining Management And Budget Approaches: An interesting strategy of the Texas report, and of the governor and legislative leaders in pushing implementation, is the combination of the pure budget-balancing measures with the management improvements. This avoids hard-to-defend claims of savings associated with the management changes. But it makes the management actions part of a package with large savings. For example, Chapter Five in the report claims $684 million in savings in the second year of the biennium. Almost all of the dollars are associated with three pure budget moves: (1) paying the state's teacher retirement bill late, (2) raising university tuition, and (3) making universities absorb some costs based on their balances and other resources. The summary then touts the benefits but notes that "the importance of the proposed changes recommended in this chapter cannot be measured by the size of their estimated fiscal effects alone."

Chapter Seven is another illustration of combining budget moves with large savings and management moves with little or no savings. Its recommendations produce a total benefit to the FY 1992 budget of $684 million. Of this, about 83% is associated with borrowing money for capital projects rather than using current appropriations. Another 17% is what amounts to a tax increase by delay of a tax exemption scheduled for machinery and equipment. The third component is the management one, centralizing debt issuance, with claimed savings of 0.013% of the savings claimed in the chapter.

In the generalizations with which the media and legislature must work, the result is pressure on legislatures to support the report, with distinctions between budget-cutting recommendations and management recommendations tending to be obscured.

Savings And The Texas Report: While the report is being considered as a cost-saving measure, those who think government spending should be cut won't find it a strong guidepost. The authors take the view, correctly, that in most state activities Texas spending is extremely low by national standards. They conclude that fiscal pressures during the oil price declines of the early 1980s put so much pressure for cost cutting on the state that "the frills, the obviously unneeded services, were gone." They also determined not to endorse reductions in "needed services." As a result, the report is mostly about how to manage better and how to raise money by taking it from other pockets. Those sources include taxpayers, balances in state funds, the financial market through borrowing, university treasuries, students, and the federal government.

In the process, however, the report left untouched a substantial number of relatively sacred cows that have come in for criticism, if not change, in other states. First, Texas has an expensive prison system primarily because it has many more prisoners in relation to population than most states, suggesting prospects for diversion programs and community corrections. Second, there may be substantial potential to reduce the institutionalized populations with mental illness or retardation by greater use of community programs. Third, like other states Texas appears to have experienced a significant decline in the productivity of university faculty (measured as student-credit-hours per faculty member) and an increase in the number of years it takes students to complete degrees. Other examples: downgrading and perhaps abandonment of some highways in sparsely populated areas, choice in elementary and secondary and higher education, and limits on employee supplemental benefits.

TAX POLICY ISSUES

Introduction: This years' legislative sessions and the Medicaid bootstrap financing issue have produced several tax policy controversies, most with ramifications beyond the state and tax immediately involved.

Bootstrap Financing Precedents: Because the discussion of federal regulations on bootstrap financing is taking place among people primarily familiar with health care finance, there doesn't seem to be much understanding of how it relates to normal state financing procedures. In this context, there are three activities falling within bootstrap financing, often called Medicaid provider taxes and donation programs. They are: (1) donations, (2) provider assessments and taxes with a base of Medicaid activity, and (3) provider taxes on a broader base.

In the first two, the provider is truly getting something for nothing. This works only if the federal government provides the additional resources. The precedents for such activities exist only within the universe of federal programs, where the practice is known as "soft match." The precedents arise when a state or local government, or more often a non-profit social service provider, counts spending it would be making in any case as a match for federal funds. The best example was the federal social service (Title XIX) program. Research or demonstration grants to not-for-profits (e.g., day care centers, community mental health centers, clinics, and universities) have also used this type of soft match. The line between donations in Medicaid and the "taxes" that use Medicaid spending as a base is very thin. In both cases, the higher reimbursement is contingent on the provider payment. Donations pay the provider when the provider donates, which is in the provider's interest to do. The tax makes the decision for the provider.

The third type of bootstrap financing differs considerably from the other two because some of the provider-taxpayers and through them certain health care customers make payments they clearly wouldn't make voluntarily. State action forces some customers to subsidize the consumption of others. ***There are many decades-old precedents for broader taxes on providers that subsidize special services for all customers within a given group.*** This financing mechanism is most often found within state-regulated businesses.

State public utility commissions regulating electric, telephone, and gas service have often established lifeline rates. These rates provide services at rates lower than charged other customers to poor persons (with a means test) or persons with low consumption who are presumed to be poor. The extra money to pay for the subsidy comes from the other ratepayers. While no "tax" is involved, the formal ratemaking procedures of the state commissions make explicit the subsidy involved, its cost to provide, and how the cost will be allocated among customers. Economically, the result is the equivalent of a tax on all consumers with proceeds distributed to the utility to fund the subsidy.

These charges aren't normally separately stated, which doesn't make them any less real. In telephone service, the new service for the deaf being implemented pursuant to a federal mandate is separately stated. In fact, states like Maryland have discovered substantial customer resistance. Some local jurisdictions use special telephone taxes to fund their 911 services.

In broader terms, considerable utility service uses the concept that everyone should pay the extra costs of serving someone with special needs. Sometimes these are related to low income service, more or less, such as the subsidies that result from rules prohibiting utility cut-offs for non-payment of bills. But another example is the extra costs of providing electric power to remote locations, which is often provided without extra charge.

State insurance regulation often subsidizes needy groups, though not necessarily the poor. Assigned risk pools work this way. All policyholders pay a premium to reduce the costs of those that would otherwise have extraordinarily high premiums, such as small group buyers of health insurance and drivers with histories of many accidents or traffic violations. State taxes for Unemployment Compensation and (in the states not relying on private insurance) Workers' Compensation use the same principle. The tax on everyone is higher because state policy caps the extent to which industries with high loss experience must cover their own costs.

Not all state provider taxes are oriented toward Medicaid matches. Indigent care, without Medicaid match, has long been an object of hospital taxes in some states including Florida, Massachusetts, and New Jersey. New Jersey renewed and modified its plan this year. The money from the hospital assessment will partly fund Medicaid match, but will also be used for activities like local health planning, a study of hospital bad debts, and supporting extended hours in community health centers.

Earmarked Taxes: When revenue sources are earmarked for a particular purpose, there is usually a connection between the source and the expenditure, such as gas taxes used for highway construction and fishing license fees used for fish stocking. Sometimes the connection isn't particularly close, such as the tendency to earmark for debt service.

The transit agency serving the Philadelphia area (SEPTA) is one of the few major mass transit agencies in the country without a dedicated tax revenue source. Most have sources like regional sales taxes or gasoline taxes. SEPTA was a winner in the Pennsylvania legislative session that just ended. What it won was dedicated revenue from statewide taxes. The $1 tax on tires and the 3% tax on auto leases have some relationship to transit, but the expansion of the 6% sales tax to magazines doesn't.

Ending Sales Tax Exemptions: As states move to limit exemptions from the sales tax, many definitional problems have been arising that raise mixed issues of economics, politics, and law.

Non-food items traditionally sold in grocery stores have been an exciting issue. New Jersey extended its tax to these items in 1990, only to watch a tax protest movement adopt toilet paper as a symbol. This year, despite difficult fiscal problems, New Jersey legislators repealed the tax on toilet paper. Presumably fearing a comparable result, Pennsylvania legislators exempted toilet paper and feminine hygiene products from the extension of the sales tax to household paper products they adopted in August.

These issues, and the frequent debate over taxing nonprescription drugs, don't involve fine distinctions concerning the food exemption. That exemption is straightforward: if you eat it or drink it, it is exempt. But legislators in states with food exemptions have shown increasing interest in carving out some traditional "food" items to be taxed.

One approach is distinguishing "drinks" from "food." A starting point is bottled water, which California will begin taxing this year. Another is "soft drinks," which creates tricky problems. For example, if orange juice is food and cola drinks are soft drinks, what are orangeade and similar items, or Kool-Aid sold in solid form to be mixed with water?

This year's excitement comes from decisions to tax "snack foods" in California and Maine. The states differed in their detailed decisions. For example, Maine will tax ice cream and nuts, but California won't.

Quibbles over definitions have their uses. Georgia was scheduled to implement a partial exemption for food this year, based on compromise definitions reportedly recorded initially on a cocktail napkin. The general thrust was to exempt fresh food (e.g., fruit) but not prepared food (e.g., Twinkies). But there were many definitional problems as well as conceptual ones, such as exempting caviar and taxing potato chips.

These issues will be back in many legislatures. In states without a food exemption (e.g., Virginia), many leaders put an exemption high on their agenda. In states with an exemption, when fiscal problems arise, legislators will again be looking at lists like household paper products, soft drinks, snack foods, and more. The issues won't easily be resolved because they concern notions of "good" foods and "bad" foods.

There is irony in these debates. The purpose of the food exemption is to avoid taxing necessities that are consumed disproportionately by the poor. But repealing exemptions on items like snack foods strikes the poor more disproportionately than would repealing all food exemptions. Concerned with this problem, some Minnesota legislators considering taxing expensive food (e.g., caviar) but not cheap food. The approach didn't go far because most food comes in expensive and less expensive forms.

Sales Tax On Production Equipment: While conceptually the sales tax is a levy on consumption, a substantial but difficult-to-measure portion of the tax is paid by producers, that is business.

Businesses buy items, by definition, solely for the purpose of reselling them or using them to produce a good or service that is itself sold. Consistent with the concept of a sales tax reaching only the final sale, states have broad sales tax exemptions for business. Purchases for resale (e.g., by a grocer from a wholesaler) and purchase of components for physical incorporation (e.g., a transmission to go into a car) are generally exempt. Practices differ more on subjects like purchases of machinery, construction materials for a plant, office furniture, and office supplies.

Many states exempt manufacturing machinery and equipment on the grounds that conceptually it shouldn't be taxed and/or that taxation would be a barrier to economic development. A few states accept these arguments partly, and tax the items at a special low rate. Texas has legislation to phase out its tax by 1995. Postponing the phase out is one of the Texas Performance Review recommendations. The Review list of the states currently taxing such sales and the rates appears in Table 3. The states marked "*" have special provisions designed to exempt machinery in some circumstances, typically if being installed as part of new plant construction or expansion. States not shown don't apply a sales tax to machinery and equipment purchases. They either have no sales tax or have one but don't tax such purchases.

Table 3: State Sales Tax On Production Equipment, May 1991

State	Rate	State	Rate	State	Rate
Washington	6.50%	California	4.75%	North Dakota	3.00%
Texas	6.25	Missouri*	4.23	Wyoming	3.00
Florida*	6.00	Georgia	4.00	Nevada	2.00
Kentucky*	6.00	Louisiana	4.00	Alabama	1.50
Nebraska	5.00	Hawaii	4.00	Mississippi	1.50
New Mexico	5.00	Minnesota	4.00	North Carolina	1.00
Utah	5.00	South Dakota	4.00		

Taxing Free Goods: An obscure controversy arising from the new California tax legislation may have nationwide significance for state taxation of advertising and even direct mail sales.

California extended its sales tax to newspapers, which is a straightforward exercise of applying the tax rate to the price charged for the paper. But the calculation yields zero tax when applied to the many papers that are free, such as suburban shopping papers, collections of ads, and the free newsstand papers found in some areas. California decided to tax some of them also. The tax base is the purchased inputs, basically the printing costs. The free papers are looking or administrative rulings and/or legislation and/or judicial decisions to block the tax.

The issue has several rounds to go. Some of the free papers are likely to convert to priced papers by charging a nominal price, like one cent. The tax on the resulting revenue would be much less than a tax on printing costs. This could also be the case for many newspapers and the slick magazines sold to specialized business audiences, where subscription revenue is often less than production and distribution costs by a substantial margin.

The discussion of taxing advertising has considered the tax base to be the sale of advertising services. For example, the base would be the payment from a consumer products company to an advertising agency. If a "free" item were taxed, then the base would be something like the production cost of a network TV show.

Taxing Mail-Order Sales: Large volumes of mail-order sales continue to escape state and local taxes, depriving state and local governments of $3 billion or so in annual sales tax revenue. Customers are obligated to pay a use tax on this merchandise, but there is no economically practicable way of getting them to pay it without cooperation of the mail-order companies. Shielded by a U.S. Supreme Court decision (Bellas Hess), many aren't cooperating.

State officials are backing a bill in Congress to deal with the situation. it is stalled primarily because local officials want guarantees of some of the money. Any legislation likely to pass would relieve vendors of learning all local rates and just permit a statewide rate with distribution to local governments by the state.

In this context, action of the Missouri legislature this year is significant. It repealed the local use tax entirely and enacted a single statewide use tax payable to the state of 1.5%.

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Air Wars: (continued from Issue 15): Colorado's Supreme Court has affirmed the constitutionality of the incentives passed in the recent special legislative session. Kansas City voters rejected (62-38%) the extra local tax to subsidize a site for McDonnell Douglas. Neither firm has selected a site.

Bridgeport Bankruptcy: As reported in Issue 15, the federal bankruptcy judge with jurisdiction over Bridgeport's attempt to obtain bankruptcy protection rejected the contention of the State of Connecticut that the city has no authority to file for bankruptcy.

The next issue for the court was whether the city is really insolvent and thus deserving of the protection against creditors afforded by bankruptcy laws. Reflecting the position of state government and many outside critics of the city's attempt to seek bankruptcy protection, the judge rejected the city's position. This leaves the city where it was before, but poorer because of legal fees and any loss of reputation.

Bootstrap Financing Of Medicaid: The latest states to act on their budgets are being even more aggressive in adopting Medicaid donation and provider tax financing than the legislatures that acted earlier in the year. The Texas program for hospitals alone involves over a billion dollars a year in state (that is, in hospital) and federal money. Pennsylvania adopted an extensive program also.

Predicting that bootstrap financing could cost the federal government $13 billion by the end of FY 1993, federal officials have drafted a regulation to limit the practice. It would prohibit use of provider donations as Medicaid match. Taxes on Medicaid providers would also be disallowed as match unless they were general taxes on providers with no guarantee that revenues would flow back to the taxpayer.

State officials will fight implementation of the regulation. At the National Governors' Association meeting in August, Governor Clinton pushed other governors to increase their level of interest in bootstrap financing, which he characterized as a "very big deal." He pointed out that the federal action affects this year's budgets. He noted it could force options of raising taxes, cutting Medicaid, or cutting other programs to finance Medicaid.

Gambling: In its annual survey of gambling, Gambling & Wagering Business (8/15-9/14) finds the total amount legally bet in the U.S. in 1990 was $286 billion, over $1,000 per capita and over $2,500 for every employed American. The gross wager (handle) exceeds gambling losses and gambling establishment profits by wide margins because winnings are often recycled and thus counted many times.

The changes from 1989 reflect the continuing decline of on-track horse betting, which experienced a 1% decline in handle. State decisions to allow simulcasting of racing from other tracks and off-track betting gave the industry a 1.4% increase in gross revenues. The big gainers, from low starting points, were Indian reservation gambling (33%), legal bookmaking (17%), casinos (16%), and card rooms (11%). State lotteries gained 7.9%. The lottery sales results were uneven as shown in Table 4.

Table 4: Percentage Gain In Lottery Sales, 1989 to 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Minnesota	*	12	New Hampshire	12%	22	Missouri	1%
2	South Dakota	545%	13	Delaware	10	23	Iowa	0
3	Indiana	220	14	Connecticut	8	24	New Jersey	-1
4	Montana	100		**United States**	**8**	25	Arizona	-2
5	Virginia	74	15	Maryland	8	26	Washington	-2
6	Idaho	70	16	Rhode Island	8	27	Maine	-4
7	Colorado	62	17	Ohio	7	28	Kansas	-7
8	Wisconsin	42	18	New York	5	29	Pennsylvania	-7
9	West Virginia	27	19	Illinois	4	30	Oregon	-11
10	Vermont	18	20	Massachusetts	1	31	California	-12
11	Florida	15	21	Michigan	1	32	Kentucky	-18

* New lottery, first sales in 1990.

The striking gains were mostly scored by newer lotteries that account for a small percentage of total national sales. The larger and older lotteries, such as those of California and New York, didn't have such a good year. Part of the problem is recession, which tends to affect consumer purchases of about everything including lottery tickets.

Further gains in lottery sales nationally seem likely. Lottery states now account for about 75% of U.S. population. Two large states, Georgia and Texas, have scheduled lottery measures for statewide votes soon. Overwhelming approval is expected in both cases. Louisiana's lottery begins operation in September. Approval also seems likely soon in several other states. So lottery revenue gains will result from larger markets.

Revenue is also likely to gain from new games, specifically the video lottery terminals that account for much of South Dakota's spectacular gains in Table 4. Many states are considering adopting VLTs. In addition, **Reports** expects some states to increase gross revenues -- though perhaps not net revenue to state government -- by increasing the player's odds of winning. A player spending (losing) $10 on a lottery with 50% odds will generate gross revenue of about $20. With odds of 60% for the player the same $10 of player loss and state net revenue will generate gross revenue of about $25.

Gambling & Wagering Business expects a continuing growth in non-conventional legal gambling. Gambling casinos are opening on Indian reservations throughout the country, though the magazine is concerned that they may become "a back door for organized crime to re-enter the gaming industry." Special arrangements -- cruise ships, riverboats, and special Western gambling towns -- all appear to be drawing big crowds.

Health Plans: Probably the most ambitious state health plan adopted this year, excluding Hawaii, was Minnesota legislation providing coverage for about 35,000 residents starting next year. It was designed to expand in five years to cover all of the estimated 400,000 uninsured residents. Initial financing was from an increase in the cigarette tax. With full implementation, costs were estimated in the wide range of $300 million to $1 billion a year. Citing costs and alleged deficiencies in the plan, the governor vetoed it. Override is possible, but unlikely.

Oregon's plan for the prioritization of Medicaid services has all the state legislative approvals and funding Oregon health officials think they need. Next stop is the federal government for a waiver of Medicaid regulations which is needed by the end of the year so Oregon can start the plan on schedule next summer.

State Health Notes (July-August) reports the number of states with "basic benefit" private health plans reached 20 as a result of the 1990 legislative sessions. Although some are adopted with great fanfare, the substance of the laws is simply to exempt private plans from mandated coverages (e.g., mental health) previously required by state law. The laws also limit employers who may provide such plans using criteria such as small size or absence of a previous health plan. Some stipulate what services must be in a basic plan.

State And Local Finances, Light At The End Of The Tunnel: The latest Commerce Department estimates of the components of gross national product suggests state and local finances may be improving. Because of balanced budget requirements, revenues and spending shouldn't be showing large imbalances indefinitely. The results for the second quarter of 1991 show a deficit for all state and local governments combined of $34.7 billion, a substantial improvement from the deficits of $41 billion in the first quarter and $44.8 billion in the fourth quarter of last year.

States With No Budgets: In late August, only two states were without budgets. Connecticut continued the stalemate between a governor who insists on an income tax and a legislature that won't pass one. The governor has already vetoed three budgets financed by revenue measures other than an income tax. Michigan didn't have a budget, but wasn't overdue as its fiscal year starts in October.

As states operated without budgets or continuing resolutions, there were many differences in appropriations law interpretations. Connecticut paid for "essential," but not "non-essential" services, a distinction made nowhere else. Pennsylvania paid prisoners but not guards. Several states paid welfare recipients but not school districts or employees. Several governors asserted authority to continue government by executive order. Many of the decisions were of doubtful legality, but won't be the subject of final court decisions. Passage of appropriations results in payments to everyone and moots the pending cases.

Who holds the record for going without an enacted budget? No one knows. Perhaps it is a state disrupted by the Civil War. The modern state record seems to belong to Pennsylvania which enacted its budget in June of 1956, 11 months into the fiscal year. The runner-up is Ohio for enacting a budget in December of 1971. In both cases, as in Connecticut, the governor wanted an income tax and legislative majorities didn't. The tax was enacted in Ohio, but not in Pennsylvania until years later.

Vermont Leadership Passes: Vermont's Governor Richard Snelling died of a heart attack in mid-August. The last governor to die in office is believed to be New Hampshire's Governor Gallen in 1982. Snelling, a Republican, was a key to enactment of the comprehensive tax increases and budget balancing measures that passed the Vermont legislature earlier this year with considerably less acrimony than experienced in other states making similar fiscal adjustments.

Vermont, like some smaller states, doesn't have the governor and lieutenant governor run as a team. So the new governor, Howard Dean, is a Democrat. He will serve until inauguration of a new governor in January of 1993. The 1991 legislative actions were designed to put state finances on a sound footing for several years, so little legislative activity is expected in 1992.

Grant Reform And Federalism: Governor Snelling was in his fifth two-year term. His earlier terms spanned 1977 to 1985. During that period he was a national leader in the "sorting out" negotiations. They involved moving power and fiscal responsibility for some programs to state and local governments while increasing the federal role in income-tested programs.

The negotiations never produced agreement, but the policies contemplated have gradually been implemented. Federal emphasis, as measured by spending, has shifted from many smaller grant programs to income-tested programs (Food Stamps, AFDC, Medicaid, Compensatory Education). More money goes to state governments and less directly to local governments.

More proposals along these lines are being made, including proposals this spring by the President, NCSL, and NGA. Their history and substance are summarized by Bruce McDowell (Advisory

Commission on Intergovernmental Relations) in ACIR's Intergovernmental Perspective (Summer).

He gives Snelling credit for the proposal that most federal grants be eliminated in favor of equalization grants to the states. The plan would work much like school foundation aid programs of the states.

Another concept associated with Snelling (and others) resurfaced in the health care policy statement being considered by the nation's governors. Its central thrust is that the federal-state sharing of costs and responsibilities be sorted out. The federal government would assume responsibility for long-term care, primarily nursing home care of the elderly and institutional care of the severely retarded or disabled. This would reduce state Medicaid costs by about 40%. The states would be expected to use the freed resources for substantial attempts to expand availability of other health care.

TECHNICAL NOTES

Bootstrap Financing: For assessments of the risks and gains as well as the outlook for Medicaid bootstrap financing, see Issues 14 and 15.

Industrial Midwest: There isn't any rigorous definition of what states constitute this group. Its core is Illinois, Indiana, Iowa, Michigan, Minnesota, Ohio, and Wisconsin. Conceptually, the category would be neater if the substantial agricultural portions of these states could be excluded. Arguments can be made for including Upstate New York and Western Pennsylvania, and perhaps Missouri.

State And Local Finances: To present the data on deficits **Reports** had to estimate the corporate profits tax accruals, which constitute only about 2.5% of total revenues. The data, which appear in the Survey Of Current Business (dated July and issued in mid-August) typically show some deficit for complex reasons related to how national income accounts are kept. Basically, when the new borrowing of state and local governments for long-term capital outlay exceeds repayments, a deficit will appear. The deficits don't include pension funds, which run at a surplus of about $70 billion a year.

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September 1991 (First of Two Sept. Issues)

ASSESSING BUDGET PROCEDURES

Introduction: Legislators, lobbyists, and media observers had many reasons to be dissatisfied with state budget procedures this year -- more than in most years. The major problem was that they produced situations apparently requiring votes for tax increases and/or spending cuts. They also led an unusually large number of states to miss their deadlines for budget enactment. In many cases, bills were voted upon by members who admitted they hadn't read them because there wasn't time. As a result, there are many reappraisals built around the concept of doing better next year.

The Budget In The Legislature: Procedures in the legislatures themselves seem least likely to change. Rank and file members not on appropriations or revenue committees felt excluded from the process. Where circumstances permitted budget enactment without minority party votes, minority members and leaders felt excluded. Interest groups often felt left out of and uninformed about key last minute negotiations. Media personnel complained that compliance with open meetings laws was inadequate. These criticisms are persistent ones, but the reforms designed to deal with them often seem not to alter the results in the following legislative session.

Part of the problem is that rules changes don't always have the results intended. For example, Pennsylvania made changes back in the late 1970s to end the extensive floor debates with multiple amendments that had slowed the budget process. But with a budget not enacted until well after July 1 this year, there is some discussion of reverting to more open budget procedures. At the federal level, one purpose of moving the fiscal year to an October 1 start date was to enable the Congress to have time to enact a budget before the beginning of the year, which hasn't worked well. In Illinois, the plan to avoid partisan deadlock on reapportionment was to have a critical member of a reapportionment panel decided by lot if legislators couldn't agree. The result wasn't agreement, but decision by chance.

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There were a few new procedural twists this year. The Texas legislature, acting in special session, managed to move its complex revenue legislation and a biennial budget without conference committees. The House passed its bill. The House-Senate negotiations then took place before the Senate passed its version. Then the compromise measure was passed in the Senate and accepted by the House. In Ohio, and probably in other states, some key tax proposals appeared as a conference committee result without having been in either the House or Senate bill. The chairman of the conference committee told an audience of private detectives that the tax measures were handed to the conference committee members three hours before the scheduled committee vote. The list, assembled by legislative leaders and the executive budget office, included applying the sales tax to detective services. The chairman told the statewide organization of detectives that he apologized for the manner in which it was done and noted they didn't have any time to try to stop the tax proposal.

Vetoes Of Budget Provisions: Also unlikely to be changed, because the powers are in state constitutions, are the roles of executive vetoes in the budget process. In most states most of the time, the veto power is rarely used on major parts of budget legislation, though governors with item veto powers use them to eliminate particular projects. There were some extensive uses of the veto this year. The one with the most impact was in Connecticut, where the governor's veto of three measures without income taxes led to enactment of a new income tax. In Minnesota and Wisconsin, governors restructured budgets with significantly higher spending and tax increases to austere budgets with no major tax increases. The Wisconsin restructuring involved 457 separate veto actions. In Alabama, where the fiscal year doesn't start until October, the governor has vetoed the entire budget.

The Omnibus Budget Bill Or Separate Bills? Another continuing budget process debate concerns how comprehensive the budget bill should be. One school of thought is that the bill (or perhaps several bills linked politically, if not legally, and passed simultaneously) should cover everything essential to the budget. This includes appropriations, taxes, other revenue measures such as fee changes, and laws clearly affecting spending such as health care provider reimbursement rates, welfare payment levels, and employee pay. This view keeps all legislation affecting spending and revenues consistent. But it moves many issues out of subject matter committees and into the finance committees, produces 1,000+ page bills that members don't have time to read, and leaves many legislators with the feeling they are excluded from major policymaking.

The alternative view is to keep substantive legislation out of appropriations bills. This solves some of the problems of the single bill, but presents the problem of inconsistent provisions. Another problem arose in Connecticut in September. With considerable agony, the legislature passed its controversial budget in August including a new income tax and various fee increases. While the fee increases were in the financial totals on which the budget was based, they weren't in the bill that passed by the narrowest of margins. So there was what some states call a "trailer bill" to be passed in September. In Connecticut, the measures are called "budget implementation bills." They are normally approved automatically, but not this year.

When time came to approve the trailer bill, the votes weren't there as legislators who voted for the budget and tax increases wouldn't go on record to increase costs of drivers' licenses, car registrations and other items. So fee increases of $44 million were dropped and the loss partly balanced by eliminating $31 million from aid for local roads. Another $32 million in fee increases didn't pass either, with no corresponding spending adjustment.

Revenue Estimates: Revenue estimates for FY 1991 were wrong in most of the states by wide margins. The consequences of the errors were serious -- mid-year budget cutbacks, tax increases, depleted reserves, freezes on promotions and hiring, etc. One obvious response is to blame the revenue estimators or the revenue estimating process. Very little of this seems to be occurring.

There are several reasons for the errors in revenue estimates. First, the projection methodology of many states is quite sophisticated, with assumptions disclosed and economic models documented. For the key assumption of national economic performance, state forecasters tended to use highly defensible (though not necessarily correct) estimates such as consensus forecasts or forecasts of one of the major econometric firms. Such estimates were close to each other and close to the estimates being used by the federal government. With explicit methodologies published when estimates were made, many state estimators have been able to demonstrate that a misestimate of national numbers -- specifically not predicting a recession -- was the source of most of their error.

A second reason is that many states use consensus revenue estimating techniques, where multiple players like legislative staff, executive budget office, and sometimes private forecasters from banks and universities agree on estimates. In other states, such as California and Illinois, separate estimating groups made about the same FY 1991 estimates and thus made the same error.

When state officials make the same mistakes about the national economy that everyone else makes and when those mistakes are made by many different state estimators, it is hard to fault the estimating process. So much of the concern, as typified by South Carolina, boils down to issues of when during early 1991 the revenue estimators should have recognized the downturn. The exceptions are the few states in which partisan arguments developed over revenue estimates preceding the November 1990 elections with critics -- Democrats in Maine and Republicans in New Hampshire -- contending that the revenue estimates were overly optimistic even without assuming recession.

While the conclusion that the revenue estimating process may not be fixable appears widespread, there are any number of assessments taking place within revenue estimating agencies and by outside groups.

Saving Money: If it were ever possible to tabulate the results of the legislative sessions, the reckoning would show that little government spending in FY 1991 was eliminated in FY 1992. Much of what was offered as savings were simply making smaller increases than inflation, shifting costs to future years, and shifting costs to other payors such as university students and local taxpayers. In retrospect, the prevailing view was that expressed by Governor McKernan in a post-session interview with the Maine Telegram (8/4):

> The important thing to understand is that most of the extra costs are policy differences. How lucrative should our state retirement system be? How generous should we be in welfare payments? How much should we have for annual increases in our health insurance plans? That's where the money is.

Nonetheless, new studies aimed at stemming rising spending appeared with the budget and tax measures. For example, the Connecticut package creates the Commission to Implement Government Reorganization. It also provides for a tax review commission to examine the state's tax structure, which was sharply changed by adding a personal income tax this year. In Ohio, there is the Operations Improvement Task Force, whose chairman is talking about recommendations that could cut state operating costs 5-10%. The group's costs, an estimated $500,000, are being covered by business donations. Maryland's governor has announced he will appoint a similar panel. In Iowa, the comparable group is the Governor's Committee on State Spending.

Spending Estimates And Binding Appropriations: Those who consider budgets a binding blueprint for spending will find statistics in NCSL's preliminary report on budget actions shocking. The report indicates that post-budget actions in FY 1991 worked a major reorganization of spending priorities to benefit corrections and Medicaid at the expense of education. The changes are shown in Table 1.

Table 1: Budgeted And Actual FY 1991 Spending Increases
Percentage Increase Over FY 1990 Actual Spending

	Approved In Regular Budget	Subsequent Adjustments	Final Increase
Public Schools	7.9%	-4.9%	3.0%
Higher Education	5.8	-6.7	-0.9
Corrections	12.5	5.1	17.6
Medicaid	15.9	6.6	22.5

NCSL comments in the survey report that the same phenomenon is likely to appear when the FY 1992 results are tallied, with Medicaid and corrections again outpacing appropriated amounts.

Revising The Texas Budget: Governor Richards signed the new Texas budget just before the September 1 beginning of the fiscal year. While approving it, she called for unspecified "truth in budgeting" reforms to be enacted when the next budget is considered. Her concerns: "If the average Texan wanted to see how much money Texas spends, they would need a lawyer, an economist, and a computer programmer to find the true bottom line ... Our budget is a maze of special funds and transfers, and spending that does not show up in line items, but instead is hidden in special riders."

HEALTH CARE FINANCING

Introduction: Health care continues to draw attention in state government because of its overriding fiscal significance as well as its importance to state citizens. On the revenue side, potential federal disallowal of bootstrap financing is nearly as much a risk to state finances as a national economy that fails to recover from recession as predicted. Medicaid, employee health care, and other health spending account for the bulk of spending growth in many state budgets and will probably account for most of the overspending of appropriations in FY 1992.

The level of frustration over health care at the summer National Governors' Association meeting was high. The reasons are clear when stated starkly. Medicaid costs are likely to rise at double digit rates. The likelihood of federal solutions is low. The possibility of federal withdrawal of reimbursements in bootstrap financing situations is high. Little money is available for prevention programs. Efforts to make health insurance more widely available have inherent problems, as they generally involve reducing coverages previously mandated by states. The number of Medicaid recipients has been growing. While the data aren't in yet, the percentage of people covered by private insurance has probably been shrinking.

Governor Gardner (WA), who chaired the conference, commented, "In my seven years in this association, I have never seen this intensity on an issue before." The governors' resolution called Medicaid "broken." Many governors expressed concern over the high costs of health care relative to other countries and over deficiencies in health care availability. Much of the governors' debate concerned how fast they should urge health care improvements leading to some form of universal care, not whether they should urge the improvements.

Bootstrap Financing Of Medicaid: State concern over potential federal regulations disallowing provider donations and taxes as Medicaid match has been mounting as more state officials recognize the consequences of losing the money. At the governors' meeting, Governor Edgar (IL) warned that the regulations could be disastrous. If promulgated, he predicted that in Illinois "we will see hospitals and nursing homes close."

While some governors and others are warning about impacts, the consequences of major regulatory change in bootstrap financing aren't well understood. For the significantly affected states, changes in the bootstrap financing rules will have the effects in FY 1992 and FY 1993 that unanticipated recession and unanticipated soaring Medicaid costs had in FY 1991 and FY 1992. Many states responded to diminished revenues and higher health costs by continuing health programs and cutting other programs and/or raising taxes. ***Just as public schools, state universities, local aid, and various social programs felt adverse consequences from recession-related revenue losses in 1991, they may well suffer similar consequences from Medicaid-related revenue losses in 1992.***

In mid-September, the U.S. Department of Health and Human Services announced its regulations barring bootstrap financing. It estimated that 37 states would be affected on January first when the regulations take effect. OMB estimated that about $3 billion is involved in federal FY 1991, which will not be affected. The total mounts to $5 billion in federal money in FY 1992, three fourths of which will be affected because reimbursements will occur for three fourths of the federal fiscal year. Viewed on a state basis, the reimbursement loss is probably on the order of $2.5-3.5 billion in the current fiscal year and at least $6 billion in FY 1993.

This is big money for all affected states. One option will be cutting back Medicaid reimbursements or coverage. A few states, such as Indiana, tried to leave themselves in a position to do this, which may or may not work. Others will find the reimbursement loss comparable to the same size loss of revenues from any source. They may attempt to cut back Medicaid, but will encounter the same difficulties as they did in considering balancing their FY 1992 budgets. They may consider cutting back other programs, but many will have to revisit the issue of tax increases. This will be especially likely in states which already have budgets that are tenuously balanced, or not balanced. Examples are Alabama, Illinois, Maryland, Minnesota, New Hampshire, Pennsylvania, and Tennessee.

States are expected to sue quickly. Prospects for final success in this litigation aren't particularly good. The HHS regulations don't go into effect until January 1 because Congress enacted a prohibition against them that ends on that date. The existence of the prohibition implies that without it HHS does have authority to issue the regulations. But even if it failed in the long run, litigation could succeed if it resulted in a delay in the effective date of the regulations. This would save reimbursements for the duration of the delay and pave the way for the second approach.

That approach is obtaining from Congress a renewal of the prohibition against regulations of the type HHS wants to issue. That approach offers somewhat better prospects. The states have several things going for them. First, there is a strong case that inaction by the Congress will cause tax increases in many states. Second, as a practical matter, Members of Congress wanting to expand federal health care spending will have few other options. Third, given the way the Congressional budget procedures work, a vote for the prohibition doesn't appear as federal budget-busting.

Medicaid Cost Escalation: Even without problems in reimbursement, Medicaid will be taking a bite out of other programs in FY 1992. According to NCSL's preliminary survey, state revenues will rise a little over 8% and Medicaid will rise by a budgeted 12% plus a predicted large but unquantified overrun requiring supplemental appropriations. If Medicaid, a large portion of total spending, is to rise at a faster rate than revenues, then other programs must rise at a slower rate.

Some of this year's Medicaid cost overruns were being conceded almost before the ink on the new budgets was dry. For example, Maryland executive branch officials were talking about a $60 million overrun, about 6% of the Medicaid budget, in August. The governor is talking about trying to hold down costs by encouraging more preventative measures such as prenatal care, immunizations, and regular tests like mammograms and Pap smears.

Besides threatening other programs, such as education, double-digit cost escalation in Medicaid reduces the funding prospects for changes in Medicaid itself. The casualties include: (1) expanding services to additional populations by lifting eligibility thresholds, (2) providing optional services (e.g., eyeglasses) in states where they are not covered, (3) experimenting with programs such as preventive health and home health care, and (4) increasing provider reimbursement rates.

A recent General Accounting Office report reflects this conclusion in its title, Medicaid Expansions: Coverage Improves But State Fiscal Problems Jeopardize Continued Progress. The report concludes that to finance recent Medicaid expansions, "some states reduced or eliminated funding for public clinics, or cut back portions of their Medicaid programs by such actions as limiting enrollments or discontinuing optional services." GAO notes, "Given the fiscal problems of many states, reliance on such fund-shifting approaches may become more widespread."

Studies: During the late 1980s, many states appointed blue ribbon task forces to develop and recommend health care solutions. These were intended to deal with broader problems than just Medicaid, particularly the large percentage of the population lacking health insurance. Many of these, such as Pennsylvania's, simply petered out with no recommendations that were taken seriously in the legislative process. Others, such as Maine's, resulted in some demonstration programs but no major changes in the state's health care delivery system. With new governors facing the problem, there will probably be some new commissions. For example, Governor Richards has announced she will appoint a "Texas Health Policy Task Force." It will have a broad charter including making basic health care available and affordable to all Texans.

Employee Health Care: Health care costs of state employees remain a difficult issue for states and employee groups alike. Because health care benefits provided by employers are free of federal and state income taxes, employer-provided benefits are clearly preferable to having employees pay for health care with after-tax dollars. But this isn't true if the fact of employer payment causes employees to pay more and/or consume more health care services. Concern about this aspect argues for some employee participation in cost. In addition, there is inherently a tradeoff between dollars spent on greater or more costly benefits and for higher wages. In some tight budget situations, there is also a tradeoff between money spent on increased wages and benefits and layoffs, with state administrations arguing that concessions on benefits and wages are necessary to minimize layoffs. These issues have been present in every state. California and New Jersey provide examples of labor-management conflict, while Connecticut provides an example of smoother relations, at least for a time.

A recent study by the State and Local Government Labor-Management Committee indicates that cost-containment actions taken through labor-management cooperation have been more effective in the public sector than those decided by management alone. The management plans are more likely to take costs as a given and shift some of them to employees by higher copayments and deductibles and higher premiums to be paid by employees. The joint plans are more likely to stress wellness programs and reducing costs by controlling utilization and/or cost of services. The Committee, which consists of representatives of labor and organizations like NCSL and NGA, cites two local government success stories and one from the Minnesota state government.

Both California and Massachusetts left major employee health care issues for resolution after the budgets were passed. In California, the governor is engaged in negotiations with employee unions that have made little progress. In Massachusetts, the governor sought to control spending on the state employee plan through a budget item veto, but it was overridden. This has thwarted attempts to increase the portion of health care costs paid by employees. This leaves the possibility of reducing the cost (and thus value) of the state health plan by reducing benefits, an avenue the governor has indicated he will pursue.

ECONOMIC DEVELOPMENT INCENTIVES

The Economic Development Priority: State and business officials often ask **Reports** and others questions about state economic development priorities: Are states doing more? Are they spending more? Does one state do more or less than others in the region?

The questions aren't answerable without a major research project. It is relatively easy to tabulate what states spend through money appropriated to economic development agencies and hard, but possible, to develop a comparable figure for the larger number of local agencies. But this is just a fraction of what is spent in the name of development. Bigger numbers are elsewhere. In state budgets are spending for developmentally oriented highways and parks, for higher education extension-type programs, and for job training -- not to mention the overall costs of a high quality education system. Outside state budgets are the costs of state and local tax concessions and the very large concessions sometimes approved in state-regulated electric and gas rates and local water and sewer rates and terms of service. These costs aren't calculated and summed in individual states and thus can't be compared across states.

Measuring words, not deeds, isn't a satisfactory substitute, although a recent study suggests economic development has shown a consistent increase in importance as measured by a content analysis of governors' messages. The results appear in Table 2.

Table 2: Ranking of Gubernatorial Policy Priorities, Selected Years

Policy Area	1971-72	1979-80	1989-90
Elementary and Sec. Education	1	1	2
Law Enforcement/Corrections	2	8	7
Higher Education	3	12	5
Health	4	14	8
Environment/Natural Res.	5	10	3
Welfare/Social Services	6	3	4
Transportation	10	6	9
Economic Development	12	2	1

Economic Development And Taxes: There will never be agreement on how much impact the state tax increases of 1991 had on economic development relative to states that didn't raise taxes or raised different taxes. Most of the increases probably won't have any discernable effect. The increases were small or were concentrated on the sales tax to which business location isn't considered particularly sensitive except for cross-border sales. The more interesting changes are concentrated in a few states.

Pennsylvania's increase in the corporate income tax rate to 12.25% reverses prior actions to lower the rate and gives the state a double-digit rate well above competitor states. New Jersey officials quickly held a press conference to appeal to Pennsylvania firms to consider New Jersey with its lower corporate rate. Pennsylvania's acting commerce secretary complained of "border skirmishes" and argued that the two states should cooperate in economic development. USX had threatened to pull out of Pennsylvania if the manufacturers' exemption in the franchise tax were repealed. It wasn't, but a company spokesman indicates that "Pennsylvania has the highest business taxes of any of our competing states." Hershey Foods called the new corporate income tax rate "dramatically higher than virtually any other state's and will have a significant negative impact on business growth and development in Pennsylvania."

California's increase in the top bracket personal income tax will add slightly to arguments from competitors, but many, particularly Nevada, already had significantly lower taxes. The changes in Massachusetts and Connecticut are large, but their effects on development aren't clear. Connecticut lowered the corporate rate and the rate on personal interest and dividends while taxing earned income for the first time. Massachusetts repealed its sales tax on services, but has put considerable pressure on local property taxes and other revenue sources.

While tax increases have gotten most of the attention this year, there is a continuing flow of tax reductions for business. An interesting one was adopted in Louisiana. It applies to medical and biotechnology research districts, of which there will be three. The districts, like enterprise zones, will offer tax breaks to firms locating there. The Louisiana statute seems to provide comprehensive exemption from property, sales, income, and franchise taxes.

Economic Development Loans: New Mexico is folding its New Mexico Business Development Corporation. The business plan of the early 1980s, like that of some other states, was to create a private corporation to make loans in the niche created because some small businesses with good potential couldn't get loans from banks. The corporation was financed by equity purchased by the private sector (with some state inducements) and a loan from the state. Critics, particularly in retrospect, have suggested the niche doesn't exist. Equity holders have lost their stake, but the state may get much of its loan back.

California Development: California's losses of businesses to other states have recently been assessed by both the Washington Post (9/1) and New York Times (8/12). Trouble is indicated by a California Chamber of Commerce study, a Business Roundtable survey indicating many businesss are considering relocation, and by specific examples of firms that have moved or are considering a move. Reasons include high costs of housing, labor, and health care, concern over educational quality, long trips to work, Workers Compensation costs, complexity and substantive restrictions of environmental protection laws, and high corporate and personal income taxes. The prime beneficiaries of corporate moves appear to be Arizona, Nevada, and Utah.

The subject is of little concern to some Californians who see the state's continuing growth as a cause of even higher living costs, more congestion, and environmental damage. But others are concerned. The state Chamber of Commerce has a new Task Force on Saving California Jobs. The state development agency is developing an early warning system to detect and prevent possible moves. Development concerns played a role in the governor's decision to press for Workers' Compensation reforms, even at the expense of delaying enactment of the FY 1992 budget.

FEDERALISM, US AND USSR

Federalism In The USSR: State-oriented observers in the U.S. with a sense of history have probably recognized the close association between the debates now taking place in the USSR and the debates in the US between the end of the Revolutionary War and the adoption of the Constitution. The arrangements now being discussed in the USSR closely resemble the Articles of Confederation in the US. The national government is given power over external defense and foreign relations and little else. The leaders of the national government are selected by the states/republics, not by national elections.

The early American issues are the same ones likely to be faced in the USSR. Can individual states/republics opt out of the arrangement, as American states tried to do in the Civil War? Can individual states/republics erect barriers to imports from other states, still an issue with garbage in the US? Can the national government collect taxes directly or must it rely on contributions from the states/republics?

Federalism, Truck Taxes: It has long been established that the Constitutional protection of commerce among the states precludes one state from barring sellers from another state from marketing their goods. There are also cases establishing the principle that a state cannot use its tax system to tax out-of-state goods or services more than those produced locally. Cases involving this principle are still active.

For example in August the Pennsylvania Supreme Court implemented a 1987 U.S. Supreme Court case (America Trucking Associations v. Scheiner) invalidating the state's "flat" axle tax. The case, which involves $50 million in refunds to truckers, has parallels in about a dozen states. The state levied a per-axle tax of $36 which, truckers successfully argued, was more of a burden on out-of-state truckers using Pennsylvania highways rarely than on in-state truckers using them all the time.

Federalism, New Hampshire Taxes: New Hampshire has maintained its status as the only state without a sales or income tax despite a close vote on an income tax this year. One way to pursue this policy is finding ways to tax residents of other states. To this end, the state has steep hotel and motel taxes and maintains cigarette taxes and liquor mark-ups to draw business from other states. Local tracks are positioned near the borders of other states. This year it levied a special property tax on nuclear generating plants. There is only one in the state. It sells primarily to other states. The new law has what amounts to a rebate provision for the New Hampshire utilities. Neighboring New England states are suing to block implementation.

New Hampshire could lose the case, which originates in the U.S. Supreme Court under the special arrangements for one state suing another. This wouldn't be the first loss of an interstate tax discrimination case. The Granite State lost an attempt in the 1970s to impose an income tax on out-of-state commuters without taxing its own residents. In the 1980s, it lost an attempt to collect more from out-of-state residents for hydroelectric power generated within its borders.

Federalism, Alabama: A major issue in Alabama is what could be considered an import duty. Previous court decisions establish that waste products are goods moving in interstate commerce under protection of the U.S. Constitution. Alabama is charging $40 a ton for hazardous waste disposal, plus $72 a ton if the waste originates outside the state. The state supreme court has upheld the differential. Chemical Waste Management, Inc., which operates the largest facility in Alabama, has indicated it will appeal to the U.S. Supreme Court.

Federalism, New York Taxes: Pennsylvania's governor recently decided to join a tax case brought by New Jersey and Pennsylvania residents over New York's tax policy. Before 1987, New York applied its graduated income tax to non-residents working in New York, calculating tax liability based on the income earned in New York. In 1987, it changed policy to use all income in considering the appropriate tax rate for the New York income. As a result, a non-resident worker will pay a higher New York tax if he or she has a spouse working in their home state or has a part time job in the home state besides the New York job. There is also legislation pending in the Congress seeking to outlaw the practice.

STATE AND LOCAL FINANCES

Fiscal Policies Of The States: With Georgia's revenues falling well below expectations this summer, state estimators have been predicting a shortfall of $400-500 million in the enacted FY 1992 budget. Governor Miller responded by calling a special legislative session and recommending spending cutbacks -- recommendations accepted by the legislature with little change. A few legislators and many groups interested in spending wanted a tax increase. The governor argued, "Of all the times you don't want a tax increase, it's during a recession." He argued that such an increase would dampen consumer spending. California's Governor Wilson expressed a similar view early this year, "If you speak to any economist ... they will tell you that a recession is the worst time to impose new taxes."

These governors were reflecting classic Keynesian thinking about government fiscal policies. It holds that in recession, government should put purchasing power into the economy by spending increases and/or tax cuts. Conversely, in boom times, government should take purchasing power out of the economy by spending restraint and even tax increases. Such policies aren't easily pursued by state and local governments with balanced budget requirements.

A few states have been trying to accelerate spending outside the general fund through public works construction financed by bond issues and/or federal funds. Governor Dukakis announced a major program along these lines for Massachusetts, but his successor, Governor Weld, hasn't been stressing the issue. There are some massive job-creating projects in process -- particularly the Boston Harbor tunnel and clean up of Boston Harbor -- but construction depends upon environmental clearances and federal approval. The new governor has announced strict limits on the total borrowing each year, because of concerns with bond ratings and future debt service costs. A similar program from Governor Florio in New Jersey is highly dependent on bond issues, one of which was rejected by voters last year.

In Rhode Island, Governor Sundlun has been pushing pump-priming by projects like a convention center in Providence and an airport in Warwick. He is also trying to accelerate highway construction.

In their general funds, however, states are pursuing their classic policies of taxing more and spending less to try to bring budgets into balance. According to the NCSL preliminary fiscal survey, state budgets call for a growth of 8.3% in general fund revenue but only a 4.2% growth in spending. Viewed another way, the survey results indicate that the 45 states responding pumped $4.2 billion into the economy in FY 1991. This was a result of the inadvertent imbalance of budgets which drained reserves by that amount. But, if budget projections hold, in FY 1992 the states will draw $1.6 billion out of the economy to replenish reserves.

Fiscal Update: In special session in August, the Texas legislature adopted its biennial budget including many of the management and cost-cutting measures recommended by the comptroller's report described in Issue 17. The major tax increases are a five-cent gas tax hike and a revision in the base of the corporate franchise tax making it resemble the corporate income taxes of many states.

Texas may well have the largest percentage of its budget under judicial control of any state -- prisons, school finance, mental health, mental retardation, etc. State leaders have resolved to end this situation. Recently progress was made when the state defeated property-rich school districts in a state trial court over the new school finance plan. A settlement of 17-year old litigation on mental retardation programs was also announced.

Connecticut extended the stalemate between a governor who insists on an income tax and a legislature that wouldn't pass one well into August. The governor vetoed three budgets financed by revenue measures other than an income tax. The legislature then adopted a comprehensive measure featuring a 4.5% income tax. Besides closing the state budget gap, the tax will finance reductions in the sales and corporate income tax rates and reduce the taxes on dividends and interest.

Michigan leaders have indicated agreement on a no-new tax budget, though it may not be balanced. The state's fiscal year starts in October.

Temporary Taxes: This has been a big year for the enactment of "temporary" tax increases. The best example is California, where a portion of the sales tax increase is temporary.

It is easy to be skeptical of "temporary" increases. As Georgia's Governor Miller recently commented in rejecting a proposal for a temporary tax increase to deal with the state's temporary revenue shortfall, "I don't think there is any such thing as a tax that is temporary. That is like being half-pregnant." State Budget & Tax News ignores temporary taxes in its tabulations of state tax increases, so extending a temporary tax isn't considered a tax increase. Some years ago, Louisiana legislators were unable to reach agreement on a tax reform plan so they enacted a tax few of them liked -- temporarily extending the sales tax to food and utilities. This solved the state's fiscal problem, but a new problem appeared each year as scheduled phase-out of the measure created large holes in the state's budget. The tax has been renewed each year.

Another version of the temporary tax is the scheduled phase-down of tax rates. In many cases, these didn't take place this year. New York's personal income tax was scheduled to be reduced, but was slightly increased instead. Texas taxes on business property were scheduled to be reduced, but the effective date was postponed in the recent special session. The temporary label on the 1989 income tax increase in Illinois was taken seriously in the 1990 gubernatorial campaign. Governor Edgar urged that it be extended, as it was after extensive debate in the legislative session this year.

In Massachusetts, the income tax increases of 1989 and 1990 have produced a rate of 6.25%, which is scheduled to drop to 5.95%

at the end of this year. Given the state's budget cutbacks, some legislators want to continue the current rate. The governor's position is that "preventing a tax from dropping is the same as enacting a new tax."

Government Investments: In a recently released 101-page study, the Congressional Budget Office examines the economic rationales for higher government spending on physical infrastructure (e.g., highways and sewers), human capital (e.g., education and training), and on research and development. The report is lukewarm on infrastructure investments: "Although further, carefully selected investments in public infrastructure may well be productive, there is little evidence to suggest that substantial across-the-board increases in current programs would be more productive on average than private investment." Job training programs are seen as producing "modest gains" in the earnings of participants, but other human resource programs are seen as promoting non-economic goals. A few R&D programs get high marks, but most federally funded R&D is judged to expand productivity less effectively than privately funded R&D.

Government And Private Debt: American debt is so large that to pay it off would require about 23 months of devoting all the nation's production of goods and services to paying creditors. But state and local government debt isn't a major factor according to statistics compiled by the Tax Foundation in its August Tax Features. The amounts are shown in Table 3. State and local governments account for only 6.1% of the gigantic total.

Table 3: Debt Outstanding In 1991

Class Of Debtor	Amount (bil.)	Per Capita	Pct. of Total
Federal Government	$2,625	$10,432	24.7%
State and Local Govts.	649	2,[illegible]78	6.1
Households	3,860	15,[illegible]	36.3
Non-Financial Business	3,503	13,924	32.9
TOTAL	$10,637	$42,277	100.0%

Debt burdens have been growing rapidly in nominal terms and growing substantially when related to gross national product. But in relation to GNP, state and local debt has dropped since 1970 as shown in Table 4. One way of viewing the trend is that from 1980 to 1991 debt mounted by 48% of GNP. Of this 48%, state and local governments produced only 2%.

Table 4: Debt Outstanding As Percent of GNP

Class Of Debtor	1970	1980	1991
Federal Government	30%	27%	47%
State and Local Govts.	15	10	12
Households	46	52	70
Non-Financial Business	49	53	63
TOTAL	140%	143%	191%

Local Finances: Chelsea, a small Massachusetts community near Boston, has been making public finance history disproportionate to its 25,000 population. It contracted out the operation of its school system to Boston University several years ago. Now it will be taken into a state financial receivership to run through 1993. Elected officials, who become advisors to a state receiver under the plan, have been unable to make ends meet. The community has high costs associated with having the highest percentage of residents below the poverty line in the Bay State and special education status for a percentage of students three times the state average. Voters have rejected attempts to raise property taxes. The community was also impacted by the local aid reductions used to balance the state's budget. The receivership doesn't entail additional state aid nor waiver of the state's limits on unvoted property taxes.

KUDOS

Introduction: There has been unusual attention directed at state leaders in the past several months, for reasons **Reports** doesn't pretend to understand. The attention is over and above the attention accorded governors who are considered possible Presidential candidates. This article provides some samples of what is being said.

Health Care: States are commended as the "real innovators" in health care by U.S. News (8/26). The magazine cites Hawaii's mandate of employer health insurance and universal care approaches, but notes that money and federal labor law present barriers to adoption in other states. Oregon gets credit for "the nation's first rationing scheme," but the article notes it still requires federal approval. Arizona gets credit for waiting longer than other states to participate in Medicaid, so "if Medicaid were to be reinvented today, it would look a lot like Arizona's program." The key is managed care, which many states are adopting.

Health Care And Education, Oregon: According to the New York Times (8/22), "Oregon is basking in national attention for its novel approaches to education and health care, both of which survived the budget axe." The aspect of health care mentioned is the plan to have some form of universal care by 1995. The education plan, passed but not implemented, involves many changes including requiring students to chose by the 10th grade whether they are on a college or vocational track. There is also new family leave legislation. The state is headed for a major fiscal problem. An initiative approved last fall gradually reduces property tax support of schools. The state is expected to fill the financial gap. To do so, most observers believe it will need to enact a sales tax, a solution voters have repeatedly rejected at the polls. The governor will be touring the state testing public opinion before making a proposal.

Performance Of New Governors: The 18 new governors elected in 1990 are reviewed by USA Today (9/10) and given thumbs up or thumbs down ratings by five experts with backgrounds in politics (as distinct from the substance of policy). The results are listed in Table 5.

Table 5: Ratings Of New Governors By USA Today Panel

Thumbs Up		Thumbs Down	
Governor	State	Governor	State
Symington	Arizona	Hickel	Alaska
Chiles	Florida	Carlson	Minnesota
Nelson	Nebraska	Walters	Oklahoma
Roberts	Oregon	Finney	Kansas
Wilson	California	Weicker	Connecticut
Miller	Georgia		
Weld	Massachusetts		
King	New Mexico		
Sundlum	Rhode Island		
Edgar	Illinois		
Engler	Michigan		
Voinovich	Ohio		
Richards	Texas		

The raters give special credit to Governors Richards and Wilson who both "saw their political stock soar after deftly dealing with huge budget deficits." Governor Wilson is featured by Governing (Sept.) for rediscovering "his competitiveness" and moving "back toward the bipartisan centrist approach that marked his early days in Sacramento a quarter-century ago."

Welfare Reform In New Jersey And Wisconsin: New Jersey House Majority Leader Wayne Bryant gets national attention (New York Times, 9/4) as "one among an emerging coterie of black Democratic leaders who question the effectiveness of social programs championed by the party's traditional leadership." He is credited for his own economic progress as part owner of a major new office building and partner in a major law firm. He is also credited with his progress in the legislative leadership and predicted to become speaker (or minority leader as the case may be) when the present speaker steps down. He has a controversial welfare reform package oriented to work incentives. The most widely cited (and opposed) portion would deny any increase in benefits for additional children born while the mother is on welfare. Another portion would provide strong, but expensive, incentives by reducing or eliminating the welfare eligibility cut off that now occurs from marriage or from taking relatively low paying jobs.

Welfare reform in Wisconsin got national attention when Governor Thompson used his veto power to create "Bridefare." By extensive changes in language of the budget bill, which are legal in Wisconsin, he resurrected a proposal, rejected by the legislature, to deny additional benefits to teenage welfare recipients because they have additional children. A federal waiver will be required for implementation. Wisconsin also has "Learnfare," which penalizes AFDC families whose children skip school, and "Workfare," which requires certain recipients to seek work to keep benefits. Bridefare also includes an increase in benefits if a teen mother marries the father of her child.

Calling him "Governor Toughlove," City & State (8/26) selected Thompson as one of its seven most valuable public officials. Time (8/19) featured him as offering "an imaginative -- but controversial -- solution to the problems of poverty and welfare dependency." George Embrey (Columbus Dispatch, 8/28) also featured Thompson's achievements.

Vetoes In Wisconsin: There is no scorekeeper, but Thompson probably also holds the record among governors for vetoes, about 1,500. One of his nicknames is "Dr. No." The special Wisconsin rules on vetoes are assessed in State Governments (August) along with unsuccessful attempts to restrict the powers.

State Government Management: Arkansas's quality management program in general, and Governor Clinton's management leadership in particular, get rave reviews from Fortune (9/5). Also mentioned: Minnesota's Governor Carlson for stemming the tax and spending increase trend and giving more emphasis to quality management. Governor Schaefer gets high marks from Time (8/16) for his annual exercise of having top Maryland officials swap jobs to gain experience and perspective.

State Think Tanks: Think tanks with a free enterprise orientation are the subject of a feature, "Hidden Persuaders," in Forbes (9/16). These are state-level operations similar to the Heritage Foundation nationally. The examples given are: (1) Yankee Institute for Public Policy Studies in Connecticut, (2) Commonwealth Foundation for Public Policy Alternatives in Pennsylvania, (3) the Washington Institute for Policy Studies, (4) the Mackinac Center for Public Policy in Michigan, and (5) the Pioneer Institute for Public Policy Research in Massachusetts. In many of these states, election of a new more conservative governor in 1990 has given more prominence to both the ideas and the personnel of the think tanks. In broad terms, the development of the phenomenon of public policy think tanks in individual states shows that the shift of power to the state level has been widely recognized.

Utah Development: Utah's economic successes are noted by the New York Times (8/25). The state gets credit/blame for high education levels, despite low per-pupil spending, a low average wage, a right-to-work law, moderate tax rates, and "the hard-work ethic of its large, young labor pool."

Environmental Protection: The Center for Policy Alternatives has recognized state policies as "best bets" in the field of environmental protection. Winners were energy conservation laws in Connecticut and Iowa, reducing use of tax-exempt bonds by industries that pollute in Louisiana, permitting cloth diapers in day-care centers in Maine, solid waste legislation in Missouri, New Mexico, and Wisconsin, forestry in Missouri, clean water legislation in New Jersey, and attorneys general of many states for their action challenging "green ads" by which companies make more environmental claims for products or packages than can be sustained.

Reverse Kudos: Rhode Island has been getting national publicity as citizens demonstrate over the continuing crisis of the state's credit unions. When the governor closed locally insured and chartered institutions early this year, about a third of the state's citizens had their deposits frozen. Since then, aided by the state putting up bailout money, most depositors have unrestricted access to their deposits, but not everyone. Besides organizations oriented to particular issues, like Citizens for Depositors' Rights, examples of apparent corruption in state and local politics have produced widespread voter discontent with incumbents. One citizen movement, named "Operation Clean Sweep," is attempting to unseat state incumbents regardless of party affiliation.

Governor Engler gets mixed reviews from USA Today (9/13). Budget cuts and a no-new-tax posture give him a higher approval rating than his predecessor. But a serious recall effort is underway, primarily in reaction to the budget cutbacks. The no-new-tax posture may not survive, as Michigan has yet to deal with a significant budget imbalance.

Candidates in this year's Louisiana election for governor are called "quirky" by the Wall Street Journal (9/6). The story features an analogy to Latin American banana republics in dealing with Governor Roemer, former Governor Edwards, and other candidates.

MISCELLANY

Census Data: The Census Bureau count of population understates actual population with a Bureau-developed adjustment available. In a controversial decision, the Bureau opted not to use its own adjustment. Legally this decision, which is being litigated, affects the apportionment of the Congress. It does not necessarily control the apportionment of state legislatures, nor the data used by states to allocate money to their political subdivisions.

The California legislature is seeking the detailed data (the state totals have been published in **Reports** and elsewhere) for use in state legislative apportionment. The Census Bureau declined to provide it. California sued and won in a lower federal court. By a 6-3 ruling, the U.S. Supreme Court has stayed execution of the lower court orders, pending review by a federal circuit court. The immediate effect will be to preclude use of the alternative data for reapportionment for the 1992 elections.

While the immediate excitement is about reapportionment, the controversy also has major effects on the allocation of federal and state aid. With the detailed data available, there is nothing to preclude either the Congress or individual state legislatures from using population estimates for grant distributions that are different from those used for legislative apportionments.

Corrections: While the National Conference of State Legislatures is predicting that states will again overrun their corrections budgets to produce double-digit increases in corrections spending, some state officials appear determined not to let that happen. In Georgia, the budget cuts adopted in a special legislative session this fall include a reduction in corrections employees. In Tennessee, Governor McWherter is increasingly critical of "trying to build our way out of this problem." Much of the concern there is with the sharp growth in convictions for cocaine possession with intent to resell. One test of public opinion on the subject will appear when Texas voters consider in November a proposed $1.1 billion bond issue for corrections.

Education Choice: There isn't an exact count, but education choice measures were part of education or budget bills this year in many states. None will result in anything dramatic happening quickly. None are self-implementing tax credits. Some have long lead times for implementation.

The Epson plan that received national publicity was rejected by a New Hampshire trial court. It ruled that local governments cannot use tax abatements except when an erroneous assessment is being corrected or taxpayer ability to pay is the issue. Supporters, including the governor, plan to push choice measures in the 1992 legislative session. Although the litigation raised broad constitutional issues, the court didn't address them, finding that its interpretation of New Hampshire tax law dictated the outcome.

The Massachusetts plan is being partly implemented, though new regulations are expected along with revisions by the legislature. Some districts have opted to receive students who elect to transfer. Agreement of the receiving district and the student's parents is all that is required to move state aid along with the student. The aid that is moved varies, but is typically the receiving district's tuition for out-of-district students. In some local situations, there have been substantial shifts which create fiscal problems for the sending district.

Education Finance Equalization: School finance litigation remains active in many states. Little dramatic is occurring because of the long periods that elapse between the filing of litigation, trial, and appeals to reach the state supreme court. One significant development occurred in August when a financing suit was filed in Montana. It is a second generation action, following previous litigation and extensive reform measures that passed in 1989.

Colorado, which did its finance equalization several years ago, is now facing problems being considered at a special September legislative session. The details, including a shift of the fiscal years of the school districts, are complex. The overall problem is that there is greater enrollment and less property tax base than originally anticipated. Higher state taxes are a possible outcome.

Education Reform: This was not a big year for education reform, other than school financing changes. Only two states passed reform measures associated with new money. The Arkansas package is already being implemented while the Missouri package depends upon voter approval of the new taxes in the November elections. After noting, "education reform defies easy description," State Government News summarizes this year's state enactments in its September issue. Of course, much of the activity is in states -- like Kentucky, Oklahoma, and New Jersey -- that are in the midst of implementing previously enacted programs.

Extension Service: Governor Miller's plan to cut Georgia spending to balance the FY 1992 budget attacked the usual targets. One exception was the cooperative extension service, where a 42% budget cut was proposed. The service, which exists in every state, was organized over 70 years ago to disseminate new agricultural technology to farmers. With fewer farmers of greater technical sophistication, the service has broadened its activities. In urban areas, homeowners use it for soil testing and advice on lawn care. While recognizing the political clout of the service, the governor commented, "Of all the cuts I have offered, this is probably the most obvious." The legislature, in its recent special session, made major cuts but not as deep as those proposed by the governor.

TECHNICAL NOTES

Health Care: The State and Local Government Labor-Management Committee (815 16th St., NW, Suite 308, Washington, DC 20006) report is Controlling Public Employee Health Care Costs Through Labor-Management Committees.

Economic Development: Table 2 comes from an article by James Gosling (U. of Wisconsin) appearing in the State And Local Government Review (Winter 1991). There is a massive gap between academic assessments of state development policies like tax concessions and what state agencies, given their time and money constraints, can use for evaluation. A short common sense list of suggestions for bridging the gap, Monitoring State Economic Development Programs: A Guide For Legislators, was recently issued by the Midwestern Legislative Conference of the Council of State Governments (641 E. Butterfield Rd., Lomard, IL 60148).

Federalism: Recent federalism issues are surveyed in the summer issue of Publius: The Journal of Federalism.

State And Local Finances: The prevailing view on the national economic importance of state and local fiscal decisions is articulately reflected in the July/August Financial Market Perspectives (published by Goldman Sachs (85 Broad St., New York, NY 10004) in an article titled, "Macro Mountains Out of Fiscal Molehills." It concludes that while there are state and local fiscal problems with serious local effects, "the resulting restraint and hardships for individual states and communities, however, should not be mistaken for a major drag on the national economy."

The Congressional Budget Office (Second and D Sts., SW, Washington, DC 20515) investment assessment is How Federal Spending for Infrastructure And Other Public Investments Affects The Economy.

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New England continues to trail the nation according to the newest Index of State Economic Momentum. Job growth, income gains, expanding sales, and housing construction all tell slightly different stories about each state. But all suggest economic strength is centered in inland states -- a big change from the bicoastal economy often discussed in the 1980s.

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September 1991 (Second of Two Sept. Issues)

STATE ECONOMIC PERFORMANCE

National Economic Performance: As readers are aware from widespread reporting of national economic numbers, the national economy isn't doing well. The data support an interpretation that the economy is in a period of stagnation, but also support an interpretation that the economy is in the early phases of recovery.

State revenue performance is uneven whether measured in relation to individual state estimates or viewed overall. This performance, as suggested by revenue statistics in the next article, is leaving some states with fiscal problems while others are avoiding them. The most serious fiscal difficulties appear in the Southeast. The early impact of the recession was comparatively mild there. Revenue estimators apparently were banking on things not getting worse and then a reasonably quick recovery. In some of the states with the most severe problems, the revenue anticipations are so low that fairly bad news exceeds the estimates. In Massachusetts, favorable results in the last several months are causing a debate over restoring some social service cuts.

Comparing State Performance: The Index of State Economic Momentum provides an overall basis for comparing state economic growth. It is not a short term revenue estimating model, though states doing extraordinarily well or poorly in the index will generally be experiencing corresponding good or bad news in revenues. The new rankings are shown in Table 1.

The index uses three measures of economic growth in equal proportions, each reflecting growth rates for the latest 12 months for which information is available. Each of the three is compared to the national average with the differences weighted equally to provide the index. The three indicators are percentage changes in (1) population, (2) employment, and (3) personal income. For example, a state with 1% higher growth than the national average in each of these indicators would appear on the Index as +1.00.

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Table 1: Index Of State Economic Momentum September 1991

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	4.79	18	Arkansas	0.45	34	North Dakota	-0.62
2	Alaska	2.99	19	Maryland	0.20	35	Wyoming	-0.62
3	Utah	2.82	20	Kentucky	0.14	36	Pennsylvania	-0.63
4	Washington	1.96	21	Ohio	0.05	37	Alabama	-0.64
5	Arizona	1.95	22	Montana	0.03	38	Indiana	-0.66
6	Hawaii	1.68		**United States**	**0.00**	39	New York	-0.66
7	Colorado	1.23	23	Louisiana	-0.03	40	Michigan	-0.76
8	Idaho	1.14	24	South Dakota	-0.04	41	Missouri	-0.82
9	Texas	1.11	25	Illinois	-0.21	42	New Jersey	-0.89
10	Oregon	1.09	26	Virginia	-0.26	43	Iowa	-0.95
11	New Mexico	1.04	27	Mississippi	-0.29	44	West Virginia	-1.29
12	California	0.82	28	Connecticut	-0.32	45	Delaware	-1.43
13	South Carolina	0.74	29	Georgia	-0.36	46	Rhode Island	-2.02
14	Minnesota	0.51	30	North Carolina	-0.42	47	Massachusetts	-2.08
15	Nebraska	0.48	31	Kansas	-0.46	48	Maine	-2.19
16	Wisconsin	0.47	32	Tennessee	-0.59	49	Vermont	-2.31
17	Florida	0.47	33	Oklahoma	-0.59	50	New Hampshire	-3.08

A large number of states track the national economy quite closely. Sixteen are within half a percent of the average. Only 18 deviate by more than a percent, down from 24 when the index was last calculated (Issue 12). The states leading the index are predominantly Western states. The leaders include some Oil Patch states recovering from problems of the mid-1980s. They advanced sharply in the index by avoiding many of the difficulties of other states. Examples are Alaska, Colorado, and Texas -- all in the top ten. New England states monopolize the bottom ranks.

And The Last Shall Be First: It is difficult for a state to deviate much from national average growth for long. Extraordinary growth tends to lead to overheating and an eventual correction, which is how New England states moved from the top of the list several years ago to the bottom now. Local recession encourages people to move out and certain kinds of business to expand, eventually paving the way for growth from a downsized and transformed economic base. This is how states like Colorado, Oklahoma, and Texas have moved up in rankings.

There are signs that Nevada may be losing its massive edge over other states. Its margin over the national average has dropped since last quarter's index. Fiscal problems are beginning to appear as evidenced by a tax increase this year and a budget shortfall developing in FY 1992 as revenues are falling below estimates.

Personal Income Change: The personal income growth between the first quarter of 1990 and the first quarter of 1991 is shown in Table 2.

Table 2: Percent Change In Personal Income, First Quarter 1990 and 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	7.4%	18	Arkansas	4.3%	34	Michigan	3.4%
2	Utah	7.4	19	California	4.3	35	South Dakota	3.4
3	Alaska	7.3	20	Kentucky	4.3	36	Kansas	3.3
4	Nevada	7.0	21	Idaho	4.2	37	Maryland	3.3
5	New Mexico	6.7	22	Oklahoma	4.1	38	Missouri	3.1
6	Colorado	5.9	23	Pennsylvania	4.1	39	Georgia	2.9
7	Louisiana	5.9	24	Tennessee	4.1	40	Indiana	2.9
8	Texas	5.9	25	Wisconsin	4.1	41	Virginia	2.9
9	Oregon	5.6	26	Montana	4.0	42	Nebraska	2.7
10	Washington	5.4		**United States**	**4.0**	43	North Carolina	2.6
11	Arizona	5.1	27	Ohio	4.0	44	Iowa	2.4
12	Illinois	4.9	28	North Dakota	3.9	45	Delaware	1.5
13	South Carolina	4.9	29	New York	3.8	46	Maine	1.3
14	West Virginia	4.7	30	Alabama	3.7	47	Massachusetts	1.1
15	Mississippi	4.6	31	Florida	3.7	48	Rhode Island	1.1
16	Minnesota	4.5	32	New Jersey	3.7	49	Vermont	0.9
17	Wyoming	4.4	33	Connecticut	3.6	50	New Hampshire	-0.7

Although many people probably think of recession as associated with declines in income and perhaps declines in state and local tax revenue, declines have been uncommon since the Depression. Personal income tends to rise with pay boosts for the persons who remain at work and with growing interest and rental income and transfer payments, such as Social Security. Nationally, personal income in the first quarter was 4% above the previous year's first quarter. Only New Hampshire suffered a decline.

In broad terms, revenue from existing state and local taxes tends to increase at roughly the same rate as personal income. At a minimum, spending is likely to grow to match the combination of inflation (about 4%) plus population growth (1% nationally with much variation among states). With 39 states below 5% in Table 2, it isn't difficult to see why many state and local governments have increased taxes in the past year.

Job Losses: Employment change, the third component of the Index of State Economic Momentum, is one of the most sensitive indicators of economic change. The state-by-state changes are shown in Table 3.

Table 3: Percent Change In Employment May Of 1990 And 1991

Rank	State	Percent	Jobs (000)	Rank	State	Percent	Jobs (000)
1	Nebraska	4.44%	33	27	Illinois	0.17%	9
2	Utah	3.88	28	28	Mississippi	-0.10	-1
3	Idaho	3.49	13	29	Alabama	-0.21	-4
4	Arkansas	2.93	27	30	Indiana	-0.31	-8
5	Nevada	2.86	18	31	California	-0.46	-60
6	South Dakota	2.64	8		**United States**	**-.50**	**-553**
7	Colorado	2.10	32	32	Florida	-0.86	-47
8	Washington	1.88	40	33	Maryland	-0.86	-19
9	Wyoming	1.80	4	34	Tennessee	-0.92	-20
10	South Carolina	1.56	24	35	Pennsylvania	-0.97	-51
11	Hawaii	1.42	8	36	Georgia	-1.05	-32
12	Arizona	1.38	21	37	Delaware	-1.08	-4
13	Louisiana	1.36	22	38	Missouri	-1.09	-26
14	North Dakota	1.11	3	39	North Carolina	-1.11	-35
15	Texas	1.08	76	40	West Virginia	-1.54	-10
16	Alaska	1.00	2	41	Virginia	-1.56	-45
17	Kentucky	0.92	14	42	Michigan	-2.22	-88
18	New Mexico	0.88	5	43	New York	-2.26	-187
19	Iowa	0.66	8	44	Connecticut	-2.26	-37
20	Wisconsin	0.55	12	45	New Jersey	-2.47	-91
21	Oregon	0.52	6	46	Vermont	-3.42	-9
22	Kansas	0.46	5	47	Rhode Island	-3.90	-18
23	Montana	0.43	1	48	Maine	-4.73	-26
24	Ohio	0.37	18	49	New Hampshire	-5.11	-26
25	Minnesota	0.32	7	50	Massachusetts	-5.24	-157
26	Oklahoma	0.24	3				

There is a strong regional pattern in job gains and losses. The top nine states in Table 3 are West of the Mississippi. The bottom eleven are East of the Mississippi. The industrial Midwestern states, usually the primary victims of recession, didn't do badly in maintaining employment.

Retail Sales: Retail sales provide another indicator of how state and national economies are doing. The news hasn't been good as shown in Table 4. The state statistics are available only for the large states listed.

Table 4: Percent Change In Retail Sales, First Half 1990 and 1991

State	Percent	State	Percent
Minnesota	6.9%	Michigan	1.1%
Indiana	6.6	**United States**	**0.6**
Texas	5.5	North Carolina	0.3
Ohio	4.5	Massachusetts	-1.0
Florida	4.1	New York	-1.3
Missouri	3.6	California	-1.8
Louisiana	3.0	New Jersey	-1.8
Tennessee	2.1	Wisconsin	-2.6
Illinois	1.9	Pennsylvania	-3.8
Maryland	1.3	Virginia	-6.2

In the late 1980s, there was considerable discussion of the "bicoastal economy." The theory was that the nation's growth was concentrated on the Atlantic and Pacific coasts, while the rest of the country stagnated. The table is a strong indication of the reverse phenomenon.

Housing Starts: Economic growth in many areas has been fueled by construction of residences and office buildings, much of it in anticipation of continued growth. If growth fails to occur, construction grinds to a halt. Speculative building ends while building to meet normal growth is unnecessary until existing unoccupied buildings are filled. The corrections are most dramatic where the growth has been fastest, as in New England. Nationally, the resumption of growth has been slowed by tighter lending standards for banks and S&LS. Cutbacks in housing (see Table 6 in the following article) are most severe in the Northeast but increasingly include California and parts of the South. They are least severe where economies were sluggish in the mid- to late-1980s, oil and gas states and the industrial Midwest.

STATE AND LOCAL TAX REVENUES

The Economy And State And Local Revenues: State and local revenues aren't growing as rapidly as in the late 1980s. This isn't surprising as the economy isn't growing as rapidly. So there is less income growth, slower sales growth, and less new property to be taxed. However, some states are discovering worse news -- that state and local revenues aren't always keeping pace even with the slow pace of nominal (unadjusted for inflation) economic growth. The overall reason is that growth is concentrated in non-taxable activities while contraction is concentrated in what state and local governments use as their tax bases.

Income Tax Revenues: The concentration of growth in nontaxable areas is most obvious in personal income growth and income taxes. Nationwide, personal income grew by 3.6% between the second quarter of 1990 and this year's second quarter. But wage and salary income, the mainstay of the state income tax base and sole component of local wage tax bases, grew by only 2.9%. The fastest growth was in transfer payments like Social Security, Unemployment Compensation benefits, federal and private retirement benefit payments, and welfare payments. These are generally either not reached at all by state income taxes, or only partially reached. Transfer payment income grew by 10.5%, more than three times the 2.9% growth rate for wages and salaries.

Sales Tax Revenues: A similar problem is appearing in the sales tax. For openers, not all personal income is available for consumption spending of any kind. While experiencing a 3.6% increase in wage and salary payments, consumers saw a 6.7% increase in contributions for social insurance, primarily their FICA (Social Security) withholding. This cut what they had available to spend on goods and services.

Within their budgets for personal consumption, their spending priority tended to go for medical care, household operations, and transportation -- with purchases of goods cut back as necessary to make ends meet. The results are portrayed in Table 5.

Table 5: Consumer Spending, Second Quarters 1990 and 1991
Seasonally Adj. At Annual Rates, $ billions

Category	Amount 1991	Change	Pct. Ch.
Personal Consumption Total	$3,791	$168	4.6%
Durable Goods, Total	454	-24	-5.1
Motor Vehicles And Parts	188	-24	-11.4
Furniture And Household Equip.	176	0	-0.2
Other Durable	89	0	0.0
Nondurable Goods, Total	1,223	44	3.7
Food	643	20	3.2
Clothing and Shoes	219	6	2.8
Gasoline and Oil	91	7	8.0
Other Nondurable	270	11	4.3
Services	2114	149	7.6
Housing	592	29	5.1
Household Ops. (e.g. utilities)	221	10	4.5
Transportation	147	12	8.6
Medical Care	530	54	11.3
Other Services	624	45	7.8

One way of looking at these data is that consumers used nearly their entire nominal purchasing power growth for the purchase of services, leaving essentially no growth in purchases of durable and nondurable goods. With no gain in sales volume in these items, there tends to be no growth in state and local sales taxes either. Another way of viewing the situation is that consumers devoted their entire spending increase to food and services, with no growth in other categories.

The same conclusion arises from retail sales data as shown in Table 4, but classified by type of store making the sales. Stores selling items not generally subject to the general sales tax did well: restaurants and bars (3.8%), liquor stores (5.7%), service stations (4.7%), food stores (3.1%), and even mail order houses (2.4%). Those selling sales-taxed items did less well: department and variety stores (2.2%), clothing stores (0.4%), furniture stores (-5.2%), camera stores (-10.4%), and auto dealers (-4.6%).

Property Taxes: The property tax remains the mainstay of local finances. To the extent they rely on other major taxes, such as local sales or income taxes, local revenues are subject to the same problems as state revenues.

One virtue of the property tax is its relative insensitivity to recession. However, it isn't totally insensitive for two reasons. First, new property represents a significant portion of property tax revenue growth, particularly in those jurisdictions that assess new property at market value but other property at something less. So a slowdown in new construction cuts property tax revenue growth. Second, although the gaps are considerable in some jurisdictions, property assessments bear some relationship to market values. Stagnant or declining values slow or eliminate growth in the property tax base. The results can be dramatic for commercial property, such as that repurchased in foreclosure proceedings, and industrial property that is partly abandoned as productive facilities.

Property Values In Individual States: Table 6 gives a rough indication of the pressures on property tax revenues as well as how the states compare in economic indicators. It shows for selected states the change in residential building permits from the first half of 1990 to the first half of 1991. Then, for a city in the states shown, it provides the change in median home prices in the second quarter of 1991 relative to the second quarter in 1990.

Table 6: Changes In Building Permits And Prices, 1990 And 1991

State	Permits	Metro Area	Price Change
Colorado	38%	Denver	3%
Utah	20	Salt Lake	8
Oklahoma	3	Oklahoma City	4
Texas	-6	Fort Worth	-1
Minnesota	-12	Minneapolis	2
Pennsylvania	-12	Philadelphia	1
Arizona	-13	Phoenix	2
Kansas	-13	Wichita	5
North Carolina	-17	Charlotte	5
Georgia	-18	Atlanta	0
New York	-20	New York	-2
Michigan	-21	Detroit	2
Ohio	-21	Columbus	4
United States	-25	**United States**	5
Illinois	-26	Chicago	6
Virginia	-29	Richmond	5
Massachusetts	-30	Boston	-3
Florida	-32	Miami	4
Washington	-36	Seattle	-3
Oregon	-40	Portland	8
California	-44	Los Angeles	1
New Jersey	-45	Bergen/Passiac	-3

Property Tax Increases: Despite relative stagnation in property values and restrictions on property tax levies in many states, there are strong indications that property taxes are rising rapidly. This would be an understandable reaction of local officials to cuts in federal aid and state aid that has been curtailed by state fiscal circumstances. For the 12 months ending in March, the Census Bureau estimates that property tax revenues rose 6.3%. During the same period, all state taxes had revenue growth of 3.5%. For the second quarter, the estimate of property tax growth over the second quarter of 1990 is 6.5% versus 4.6% for personal income taxes and 4.7% for sales taxes.

Current data aren't available for most property taxing jurisdictions, but the Census Bureau does have information for some large ones, which are all counties except for New York City. Table 7 shows the increase in property tax collections between the 12 months ending in March and the prior year for jurisdictions that collect more than a billion dollars a year in property taxes. If these larger jurisdictions are any indication, many property tax increases were double digit. These increases reflect both rate increases and increases in the value of property taxed resulting from new construction and higher assessments of existing property.

Table 7: Percent Change In Property Tax Collections
Twelve Months Ending In March Of 1990 And 1991

Jurisdiction	State	Change	Jurisdiction	State	Change
Santa Clara	California	20.2%	Bergen	New Jersey	9.7%
Los Angeles	California	17.3	Westchester	New York	9.2
Broward	Florida	15.6	Maricopa	Arizona	8.9
Allegheny	Pennsylvania	14.1	Oakland	Michigan	8.2
Hartford	Connecticut	12.8	King	Washington	7.0
Cuyahoga	Ohio	12.4	Cook	Illinois	5.5
New York City	New York	11.9	Hennepin	Minnesota	5.2
Orange	California	11.5	Middlesex	Massachusetts	4.4
Fairfax	Virginia	11.3	Dallas	Texas	4.0
San Diego	California	10.2	Nassau	New York	3.5
Wayne	Michigan	10.2	Harris	Texas	2.2
Palm Beach	Florida	9.9	Suffolk	New York	-6.3
Fairfield	Connecticut	9.8			

State Revenues Lag: The revenue problems appear in data now being released on revenue collections in individual states, particularly those that didn't increase taxes for FY 1991. State revenues will show more substantial gains beginning with the third quarter because many state tax increases are now beginning to have an effect. The overall revenue picture is suggested by reports from Census and the Center for the Study of the States. These cover differing periods: (1) Census covers 12 months ending in March, (2) Center Q covers the second quarter of 1991 compared with the second quarter of 1990, and (3) Center FY covers the year ending in June of 1991, which is FY 1991 for most states, in relation to the prior year. Rates of growth are shown in Table 8.

Table 8: Growth In State Revenues, Selected Periods

Revenue Category	Census	Center Q	Center FY
TOTAL REVENUES	3.5%	2.0%	3.2%
Personal Income	4.3	3.4	4.8
Corporate Income	-8.9	-1.7	-5.2
Sales	3.7	0.8	2.5

The similarities in the estimates are more significant that the differences. By all reckoning, state revenues haven't been growing as rapidly as inflation, which is 3-5% depending on measurement concept and period measured. Steven Gold, who collected the Center's data, reports that the 2% increase of the second quarter would have been a 1% drop if states hadn't increased their tax rates.

Revenue Growth In Individual States: Table 9 provides the Center's estimates of revenue increases in the individual states for what is FY 1991 in all but four of them.

Table 9: Growth In Tax Revenues, FY 1990-FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Kentucky	22.5%	18	Arkansas	5.2%	34	Rhode Island	1.5%
2	Nebraska	18.6	19	Iowa	5.1	35	Indiana	1.4
3	New Jersey	14.3	20	North Dakota	5.1	36	Georgia	1.1
4	Oklahoma	14.1	21	South Dakota	5.1	37	Tennessee	1.0
5	Hawaii	12.7	22	Wyoming	4.8	38	South Carolina	0.6
6	Arizona	12.6	23	Alabama	4.2	39	Vermont	0.4
7	Texas	11.8	24	Montana	4.2	40	Ohio	0.1
8	Oregon	10.0	25	Kansas	4.0	41	Delaware	-0.1
9	New Mexico	8.5	26	New Hampshire	4.0	42	Virginia	-0.4
10	Wisconsin	7.8	27	Illinois	3.8	43	California	-0.7
11	Washington	7.5	28	Mississippi	3.8	44	Maryland	-0.8
12	West Virginia	7.5	29	Missouri	3.6	45	Michigan	-1.2
13	Idaho	7.3	30	New York	3.4	46	Pennsylvania	-1.6
14	Utah	7.0	31	Minnesota	3.3	47	Maine	-3.5
15	Louisiana	6.7		**United States**	**3.2**	48	Nevada	-3.6
16	Massachusetts	5.8	32	Florida	2.1	49	Connecticut	-4.6
17	Colorado	5.6	33	North Carolina	2.0		Alaska	n.a.

The negative numbers are the most striking aspect of the table. Most of the states with shrinking revenues have raised the taxes to be collected in FY 1992. Most of the states with double digit revenue increases had raised taxes in their 1990 legislative sessions, so their increase in collections appears in FY 1991.

INSURANCE REGULATION

Introduction: The failures of several large insurance companies have caused most concerns about state insurance regulation function to center on the task of making sure that companies maintain solvency so they can pay promised benefits. Another aspect of insurance regulation is protection of the consumer by reviewing and approving policy provisions and rates. This was a hot topic in the late 1980s, particularly with approval of Proposition 103 in California in 1988. This triggered consideration of comparable regulatory measures in other states. In addition, unique problems in auto insurance caused New Jersey and

Pennsylvania to adopt controversial reforms. This article summarizes what has been happening this year.

Ebb And Flow In State Policy: The examples of recent activity show there is little consensus about appropriate state policy on some major issues. As a result, "reform" in one state may be the exact opposite of reform in another. California reformed insurance regulation by making the commissioner elected rather than appointed. Faced with failure of a major company and scandal affecting the commissioner, Louisiana reformers are looking at appointing rather than electing the commissioner. One Georgia reform was to repeal an old reform, no-fault, while Pennsylvania's reform was to add a no-fault option. Nevada had no-fault in the 1970s, repealed it, and considered reenacting it this year. Texas reformed regulation of Workers' Compensation (WC) insurance by deregulation of rates while Georgia reformed auto insurance by reregulation. New Jersey's reform of auto insurance included eliminating a state-run plan. The Texas reform of Workers' Compensation creates a state-run plan.

State Government As An Insurer: State governments are in the insurance business in a big way. The states are insurers in Unemployment Insurance with a monopoly on this insurance line. A few states maintain a similar monopoly for Workers' Compensation Insurance, but use of private carriers is more common. There are other isolated cases of state operation of the insurance function, such as a new earthquake insurance program in California and a special medical malpractice coverage for delivery of babies in Virginia. Pennsylvania tried, but abandoned, taking a portion of auto insurance coverage with the rest handled by private companies. States don't participate in other insurance lines like fire and casualty, auto insurance, and life insurance.

The state decisions on where to be involved in the insurance function tend to be quite stable, with patterns in each decade closely resembling the prior one. In that context, a Texas decision this year represents substantial change. Like most states, Texas officials haven't been happy with their WC system as employer costs soared while employee benefits stagnated. A reform measure was passed in 1989 which is just now starting to take effect. But reform didn't solve the problem of the Texas Workers Compensation Insurance Facility, which is basically an assigned risk plan. Like many such plans, its costs have exceeded revenues, leaving a deficit of over $1 billion. The deficit is the responsibility of companies selling WC insurance in proportion to their sales. But WC rates are tightly regulated in Texas. Regulators have tried to hold down rates, creating what insurers claim are major losses even without increased assessments for the assigned risk plan.

The basic solution in the new legislation is rate deregulation, putting Texas in line with many other states depending on competitive pressures rather than rate regulation as the primary control over rates. The interesting wrinkle is a new state-run insurance fund that will compete with the companies. The fund will get its capital through a $5 million loan from the state and revenue bonds. It is supposed to be self-supporting over time. Because it won't be subject to the same premiums taxes and won't have to participate in paying off the deficit from the assigned risk plan, it should have an initial advantage over the companies. Critics of the idea were mollified when the legislature included an amendment that sets a sunset date in 1995, causing the fund to cease to exist if not renewed by the legislature.

Texas Insurance Regulation: As the 1991 legislative session began, newly elected Governor Richards was highly critical of the state's insurance agency. She urged reform in how the agency was governed and in insurance law. A fierce battle was expected in the legislature. It didn't materialize. Instead, consumer groups, legislators, representatives of the governor, and insurance company personnel negotiated a bill covering, in over 500 pages, many facets of insurance regulation.

The industry gets deregulation of rates under the name of "flex rating." It allows carriers to deviate up to 30% from a state-set benchmark rate. Flex rating applies to auto and homeowners' insurance. General liability and commercial property insurance is fully deregulated. The industry loses protection from state level antitrust laws. The board of insurance is reorganized into a department with a single insurance commissioner to govern day-to-day activities.

California's Proposition 103: One provision of Proposition 103 was that the insurance commissioner would be elected rather than appointed. In January, the first elected commissioner took office with a pledge to reduce insurance rates. Proposition 103 called for a 20% premium rollback. Insurance companies contested the provision, securing a state supreme court opinion that they deserved a fair rate of return. This made their status similar to that of electric and telephone utilities. The problem was that if this rate of return were allowed, the 20% cutback wouldn't take place and some companies would actually get rate increases. Considerable activity followed -- litigation, negotiation, rulemaking, attempts to resolve the matter by legislation, and more. But nothing happened that consumers would notice as rate relief.

In August, the new commissioner announced regulations that he said would result in $2.5 billion in refunds, over $100 per policy holder. They included limits on company costs allowed for executive salaries, political contributions and lobbying, and an efficiency standard for other expenses. The commissioner said, "These regulations establish California as the nation's leader in consumer protection." The key factor in the rate reductions was a determination that 10%, not the higher 11.2% used earlier, was the appropriate and legal rate of return. The move was announced with considerable fanfare that drew nationwide publicity. It also drew negative comments from industry sources. They claimed that the "Alice-in-Wonderland regulation" did nothing about the underlying costs of insurance -- accidents, theft, fraud, litigation, and the costs of health care.

Court challenges to the rollback were expected, but the approval in California's administrative law procedure was expected to be quick. It wasn't. In early September, the Office of Administrative Law rejected the new regulations. It interpreted the law as requiring hearings before promulgation.

On a separate track, California legislators considered insurance reform measures in the 1991 session, but didn't pass one. A leading concept involved no-fault, a bare-bones policy to appeal to the third of California drivers who illegally drive without insurance. An alternative, backed by trial lawyers and others, would make insurance more affordable for low-income drivers by extra premiums charged to high income drivers.

Reform In New Jersey: New Jersey's auto reform passed in March of 1990, redeeming one of Governor Florio's campaign promises. It was designed to cut auto insurance rates in part by removing the albatross of $3 billion in deficit of the assigned risk plan, known as the Joint Underwriting Association (JUA). It is to be handled by increased taxes and fees and by making auto insurers absorb $1.4 billion without passing the costs along to policyholders. The immediate impact of reform was to cut about $200 off annual bills of the average driver. This April the governor borrowed the original Batmobile to celebrate the removal of the charges.

The financing problems aren't necessarily over as the new assigned risk plan, the Transitional Market Facility, may itself start running up debts. Representatives of major auto insurers and legislators critical of the reforms worried that the decisions on rates for the new plan would recreate the problems of the old. The companies sued to invalidate the new law, but lost a state supreme court decision in May. Companies argued that the new law made it impossible to earn a fair rate of return, the same argument used against Proposition 103 in California. The court rejected the argument, suggesting that through the normal rate making procedure such a rate of return was possible. Companies are free to return to court if rate decisions don't provide them a return they consider fair.

The possibility that companies might try to leave the state rather than absorb the costs was anticipated. Companies that leave must leave all insurance business in the state, including profitable lines as well as auto insurance they find unprofitable. To get out, they must go through an extensive transition of up to five years. A state appeals court upheld this "all or nothing" rule this summer.

In September, Allstate, which is the largest New Jersey auto insurer, announced that it was pulling out. By its reckoning, it lost $72 million in New Jersey last year and $450 million in the last two decades. The decision affects insurance on 435,000 cars and, under the "all or nothing rule," about 250,000 homes and large numbers of boats and recreational vehicles. The governor said the state wouldn't be blackmailed into a 28% rate increase and continued:

> When I was growing up in Brooklyn, there was always one boy who would say that if you didn't play by his rules he would take his bat and ball and go home. If that's what an insurance company wants to do, we won't back down from our commitment to fairness for drivers and reasonable rates.

The Allstate decision is being announced in 800,000 letters to policyholders, so it won't be easily reversed. But the company and Garden State regulators could reach some sort of accommodation in the five years it will take to complete the pullout under state law. Critics of reform seized on the announcement as an indication of the failure of state policy. Second-ranked State Farm called Allstate's criticism of New Jersey's operating environment accurate, but is remaining in the state.

Overall, it is too early to tell what impact the reform program is having. The new taxes and fees on body shops, doctors, and vehicles are in place, reducing amounts that would otherwise be in insurance bills. The JUA surcharge has ended. Whether auto rates will eventually rise to cover the past deficit remains to be seen.

Pennsylvania Reforms: Last year's Pennsylvania reform package adopted a limited form of no-fault insurance. Drivers can close a limited-tort option that waives certain of their rights to sue for non-economic damages like pain and suffering. In return, they get lower rates. Only about a third of Keystone State drivers have accepted the option, but state officials believe acceptance will spread as understanding increases. Other options touted as cost saving actually shift risks. Examples are raising the collision deductible, reducing medical coverage, and eliminating uninsured motorist coverage. The state insurance agency says that savings in the first year have been at least $400 million. Rates are still high by national standards, over $800 statewide and over $1,000 in Philadelphia.

Dropping No-fault In Georgia: Reforms enacted in Georgia reverse some of the reforms of prior years. The state is replacing "file and use" rate regulation for auto insurance with a system requiring prior state approval of new rates.

Georgia is also dropping its no-fault system. Georgia was one of many states that reacted to no-fault pressures in the 1970s by a compromise that set a low no-fault threshold. In Michigan's comprehensive no-fault plan, medical benefits are unlimited. In Georgia they were limited to $5,000. In Michigan, permanent injury is required to leave the no-fault system to sue, but in Georgia only $500 in medical outlays was required. The hybrid system was generally seen as costing more than either a higher threshold no-fault or a fault system. Georgia opted to return to the fault system, hoping the decision along with other reforms, such as tighter rules against fraudulent claims, will produce lower premiums. One concern is that some of the costs will quickly appear as uncompensated health care costs, as immediate reimbursement for medical expenses will no longer be available.

KING COAL

Introduction: New federal clean air legislation was hung up for years over the issue of emissions from coal-burning powerplants in the Midwest. Standards stringent enough to satisfy environmentalists and Members of Congress from downwind Eastern states carried unacceptable costs in lost jobs and power prices in the Midwest. The ultimate compromise which was adopted in 1990 required plants burning high sulphur coal to change their ways. In broad terms, the choices were: (1) continuing to use high-sulphur coal and investing heavily in scrubbers to take sulphur compounds out of the air or (2) substituting low sulphur coal for high sulphur coal.

The Issue: The low sulphur coal alternative was deemed preferable in analyses by major companies in Ohio and Illinois. With both alternatives meeting air pollution goals, the key factor in the analysis was cost, which under rate regulation logics of both states would be passed on to consumers.

The low sulphur choice meant switching from local coal mined in Southern Illinois and Southeastern Ohio. That coal has high sulphur content which cannot economically be removed, though both the coal and electric companies and the State of Ohio have invested in R&D on reducing sulphur content. The beneficiaries of the switch would be coal companies and miners in the West.

The Decisions: The Illinois decision was contained in legislation passed this year. In substance, it requires the use of Illinois high sulphur coal at the Illinois plants involved. It is expected to save something like 2,500 mining jobs. The cost is estimated to be about $1 a month (starting in 1995) to residential electric customers of the company serving the Chicago area.

The Ohio problem was concentrated in one plant owned by the seven-state holding company American Electric Power (AEP). The plant's coal is supplied by an Ohio mine owned by the company. The legislative solution was to seek to protect the 1,200-1,300 mining jobs by offering a tax credit. The credit is $1 per ton for companies that opt to burn Ohio coal and use scrubbers. The legislation covers plants that already have scrubbers, bringing its estimated cost to about $20 million annually and the coal mining jobs involved to about 7,000.

Under the Ohio law, AEP is not required to burn Ohio coal. With the compliance date in 1995, it still has time to make a decision. While the legislation was being considered, company officials indicated that even with its incentives, closing the mine might be appropriate. A company official estimated that the credit would be about $6 million annually, while the cost of compliance would range from $125 million to $230 million.

In signing the legislation, Governor Voinovich was critical of his predecessor for not taking more effective action to prevent passage of the federal legislation. Voinovich characterized the legislation as a "Western coal, Northeastern legislator, Texas combination that got together to put the Ohio coal industry out of business." Two statistics on the legislation are widely used in Ohio. First, Ohio is responsible for only 11% of the acid rain problem but 20% of the cleanup costs. Second, electric rates in Ohio will increase about 15% because of cleanup costs.

The Math: There was considerable controversy over the substance of the Illinois bill as well as the cost of the scrubbers. They have an initial acquisition cost, maintenance costs, and energy costs from their operations. Predicting the costs of the alternative, purchases of low sulphur coal, isn't easy either. At one point in the debate, Commonwealth Edison suggested a cost of $100 million a year. Using that cost and 2,500 jobs at stake, the cost per job is $40,000 per year. Assuming one job is generated indirectly through a multiplier effect for each coal mining job, the cost is $20,000 per job per year. The cost is paid by ratepayers to the company. There are no state government outlays nor any reduction in state tax revenue.

In Ohio, there are 7,000 jobs and an annual cost of $20 million per year. That works out to a more moderate price per job saved of just under $3,000. The problem is that the calculation includes some jobs already saved because of scrubbers previously installed. Focusing on the AEP decision involves $6 billion and about 1,250 jobs or about $4,800 a job -- $2,400 if the multiplier is considered.

Debating The Issue: In Illinois, there was concern that any gain in jobs from the legislation would be offset by losses associated with higher utility rates for industrial activities. At one point, the Illinois Manufacturers' Association and Illinois Industrial Utility Consumers were opposing the legislation, along with some consumer groups.

Utility rate regulation is beyond the understanding (or interest) of many voters. The element that the Ohio subsidy would be returned to ratepayers was stressed by proponents. This would occur in any case as the subsidy would reduce the company's allowable cost. In Ohio, the general taxpayer supports saving the mining jobs while in Illinois the ratepayer does so.

These state decisions were about as clear a case of whether to spend money to save existing jobs as will likely be found at the state level. The case against action was presented editorially by the Chicago Tribune (6/4):

> It's not that coal miners or their communities are undeserving. But instead of taxing Edison customers indirectly, the state ought to tax directly and allocate the money openly, probably to supplement federal aid for displaced workers. The miners could retrain or move to another place where prospects are better. In any case, the state's function ought to be to help people adjust to and find work in emerging industries, not to artificially prop up weak ones.

In both states, more than just saving jobs was involved. The mining jobs are located in depressed areas of the state while the subsidies will come from more prosperous areas.

Other States: Other states that produce high sulphur coal have similar issues, though with different twists. In Kentucky, much of the high sulphur coal production is sold to utilities in other states and to the Tennessee Valley Authority, a federal government corporation. Kentucky cannot force use of high sulphur coal through regulation, like Illinois does, because it doesn't have jurisdiction over the companies. A credit against Kentucky utility taxes, following Ohio's approach, won't work in all cases either because there is no Kentucky tax involved. The obvious option is to provide tax credits to the Kentucky coal producers to reduce the cost of Kentucky coal. A more exotic option is to somehow become involved in buying and selling the new federally created pollution control credits that are a part of the complex federal law. There is also a difficult equity issue as the in-state privately owned utilities already have scrubbers but might need to be subsidized, as Ohio did, in the name of fair treatment for the companies and their customers.

In West Virginia, the issues are complicated because natural gas suppliers are offering their product as an alternative to both local coal and Western low sulphur coal.

STATE PENSION FUNDS

Funding Pension Plans: Many states reduced their contributions to pension plans as one way of dealing with fiscal problems. In states which manage local pension plans, such as those for teachers, the changes also relieved local fiscal pressures. The most common adjustment was to increase the assumed rate of return on pension fund investments. This enters the actuarial calculation and results in a lower employer contribution requirement. The risk is that the assumed return will exceed actual returns, so state and local contribution increases will eventually be required to cover the shortfall.

Assumed rates of return are now in the 7-9% range. This compares with about 5-6% on U.S. Treasury bills, 8% on long-term federal bonds, 9% on corporate bonds, and fluctuating total return on common stocks that has been double digit in the past year. In this environment, the 7-9% assumptions aren't necessarily out of line. But they are unlikely to be exceeded in the way that the 4-7% assumptions were exceeded in the late 1980s.

Over the past two years there have been many reductions in government contributions to pension plans as a percentage of covered payroll. But the payrolls themselves have been rising. In the fourth quarter of 1990, those contributions were $6.5 billion, up from $6.0 billion in the same quarter of 1989, but up less from $6.4 billion in the fourth quarter of 1988. During the fourth quarter of 1990, the plans collected $20.9 million from those contributions, employee contributions ($3.1 billion), and investment earnings ($11.3 billion). Spending for employee benefits was $8.3 billion. Total assets of the plans at the end of 1990 were $620.7 billion, up 8.6% from the previous year. The plans hold nearly $50,000 for each active employee.

Pension Fund Investing In Kansas: Kansas legislators have been holding hearings assessing an estimated $200 million in investment losses in the public employee retirement system. Kansas officials are pursuing criminal prosecution and civil litigation against those involved. It isn't clear that any money will be recouped. Legislation will probably develop out of the well-publicized losses, including restrictions on fund investments. Many of the investments involved attempts to promote economic development by investing in companies expanding job opportunities in Kansas. The largest single loss was $65 million in a failed S&L.

Rightly or wrongly, the Kansas experience will be a setback for "social investing" by pension funds. Many pension fund administrators oppose such investments and will cite Kansas as an example. They will also use Alaska as an example, though it suggests problems of concentrating investments as much as problems related to social investing. Like many plans, Alaska's invested in mortgages but was heavily concentrated in Alaska housing which suffered greatly in the 1980s. There was a special problem with the Alaska Supplemental Benefits System, which employees view as their own money. It has lost about $6,000 per involved employee, about 20% of its assets. Rather than adjusting employee benefits, as state officials suggested, Alaska employees pushed for the state to replace the losses, which the legislature did this year.

Pension Politics In California: This year California drew national attention for its state pension plan issues. Faced with a budget gap of an estimated $14.3 billion, the governor proposed numerous revisions in the complex public employee system which has several benefit tiers. With substantial adjustments, those affecting benefits were adopted while those affecting governance of the funds were not. The tiers, which made some benefits contingent on investment performance, are being replaced with a guaranteed cost of living increase of at least 75% of inflation. A new retirement system will be in effect for new employees. A reduction in state costs of $1.8 billion is provided by recognizing assets of the other tiers as first tier assets.

The politics of the changes got rough. The pension fund (CalPERS) trustees representing employees attacked the California Taxpayers Association. The business-sponsored research group (comparable to public expenditure councils in some other states) had been particularly critical of the old pension system in reports like Excessive Pensions: Fiscal Equivalent of Gutter Flooding. The trustees contacted firms supporting Cal-Tax suggesting a boycott of their products was possible. At least one company withdrew from the organization as a result. After passage, a coalition of public employee organizations filed suit to block the changes. Pension system administrators generated national publicity to the effect that the governor was seeking to end the system's active involvement in management of companies in which the system holds stock.

Pension Fund Activism: In the midst of the debate over reorganization of the CalPERS board, many national reporters bought the story that the attempt to eliminate employee/pensioner votes on the CalPERS board stemmed from the activism of the board in corporate governance issues. It has been a leader in taking an active investor role in such issues as potentially excessive compensation of corporate officers. The allegation was that the governor was serving large business interests by trying to remove those involved. The governor denied this. The denial is at least plausible as other governors have taken positions similar to his in states where employee retirement systems have taken no role in corporate governance issues.

CalPERS' activism is controversial among state pension plan administrators. New York Comptroller Regan, who is the trustee for the major New York plans, has criticized the approach. He sees headline-producing attacks on corporate officials as "sucking us all into a pit" unless closely tied to the fiduciary duty to obtain the best return on plan assets. He fears that activism and allowing pension funds to be used for non-pension purposes will make it easier for state officials to balance budgets by denying money to pension funds.

MISCELLANY

Health Care: Acting as chairman of the National Governors' Association Committee on Human Resources, Maine's Governor McKernan wrote Congressional leaders in mid-September to seek action to forestall regulations on bootstrap financing. The regulations would restrict state use of donated funds and taxes on health care providers to provide the state match for federal Medicaid funds. If the funds are disallowed as match, the affected states will have to supply the money from other sources or curtail Medicaid spending substantially. McKernan noted that the federal timing, with an effective date of January 1, ignores the reality of state fiscal years and predicted "immediate and severe disruption of state Medicaid programs."

Local Finances: Recent surveys by the National League of Cities and National Association of Counties show the responding local governments to be in poorer-than-usual fiscal shape. But problems are by no means uniform. Naturally, they are worse in the Northeast where the economy is in worst shape. High reliance on property taxes has shielded many local governments from losing revenue because of falling sales. The most significant problems are in the jurisdictions that are most like states. That is, they rely on sales or income as a tax base and have significant responsibilities for health and welfare programs. While temporarily out of the news, the District of Columbia, New York, and Philadelphia have continuing severe problems.

Federal Mandates: The National Conference of State Legislatures is now publishing regularly its Mandate Watch List which monitors the status of federal legislation containing federal mandates on state and local government. It also released a special study at its August annual meeting titled Fiscal Impact Of Proposed Mandates From the 102nd Congress. The documents suggest how large the potential for new mandates is. The Monitor's list runs 13 pages. Many mandates are associated with health and human service programs, but the subjects include bass fishing, voter registration, and proposed restrictions on state lotteries.

Phantom Voting: When a vote of 100-80 is reported on a bill in a state legislature, does this really mean that 100 legislators were present when the vote was taken and voted for the measure? The answer is not necessarily, even with electronic voting mechanisms. Procedures and customs develop to handle situations where the intent of the legislator is well known and the absence is brief. Because they could be seized upon by the press or by counsel attempting to void legislation, there is every reason for them not to be discussed. However, in the hard-fought battles of state budgets, these mechanism came to public attention in Pennsylvania and Texas.

In Pennsylvania the procedure is called "ghost voting." This year a Pennsylvania representative was recorded as voting for the budget on a key vote. It was recorded while, by his admission, he was in the Philadelphia Airport, not the capitol at Harrisburg.

The Texas situation concerns the votes of a representative who was not present because, as discovered later, he was dead in his apartment. Under Texas house rules, a member can vote on behalf of another if (1) there has been a specific authorization by the member and (2) the non-voter is present in the House chamber or an adjacent room.

A group called the Pennsylvania Leadership Council is threatening litigation in Pennsylvania. Such challenges normally fail. The courts are reluctant to overturn a decision taken by a legislative body and certified by its presiding officer as an enrolled bill. This is particularly the case when no objection was made at the time of the vote. In Pennsylvania, the leading case was a challenge to a legislative pay raise bill passed in the early 1970s by the deciding vote of a legislator on a cruise in Scandinavia.

Tax Increases: Who raised taxes this year, how much? Answers are starting to appear in various surveys, but the subject is controversial in some states and has difficult conceptual problems. In Georgia, the sales tax was scheduled to come off some food items, but a judicial decision blocked the change and elected officials endorsed the judicial decision. In Massachusetts, the new sales tax on services went into effect for a day or so and was repealed. In Indiana, the motor vehicle excise tax went down in the first half of the year but was then restored to its former levels. In Indiana, Kansas, Texas, and other states, the state school aid formula effectively mandates local property tax increases.

The fiscal survey NCSL released in August has apparently moved to a policy of considering an unchanged state tax policy to be an increase if a change was scheduled. So it reports that Louisiana and Illinois raised taxes by more than 5%. Taxpayers in these states won't notice any major change in their taxes. Existing levies were simply extended.

TECHNICAL NOTES

Employment: Employment data shown in Table 3 and used in the Index of State Economic Momentum reflect primary data generated by employers and reported in connection with Unemployment Insurance taxes. Because of the tie to tax administration, the data are highly reliable. However, they include employees twice if they hold two jobs. For large states and national totals, the Bureau of Labor Statistics has another method relying on household surveys. These data don't double count, but are less reliable for large states and unavailable for most states. For many state purposes, including economic development and revenue estimating, the second job is relevant. For example, loss of a second job does affect state revenues and state economic opportunity even though it doesn't result in unemployment.

Reports doesn't use unemployment rates as an indicator for several reasons. First, the structures of state economies create consistent differences. Farm states have consistently lower rates than industrial states. States with widespread supplemental benefit programs like those of the auto and steel industries have consistently high rates. Second, the denominator for unemployment is those actively seeking work. When an economy sours, some people ("discouraged workers") stop looking for work and lower their state's unemployment rate.

State And Local Tax Revenues: The data in Table 5 and on components of personal income come from the National Income and Product Accounts estimates appearing in the Survey Of Current Business (August). Median home price data in Table 6 come from the National Association of Realtors. The permits data are collected by the Commerce Department and packaged in usable form by the National Association of Home Builders in Housing Economics (August). State revenue data are from the Census Bureau Quarterly Summary Of Federal, State, and Local Tax Revenue: January-March 1991 and Center for the Study of The States (State University of New York at Albany) State Revenue Reports (August). Table 7 relies on the Census reports.

Insurance: For interesting journalistic accounts of the problems and accomplishments of the new California insurance commissioner John Garamendi see "Insurance Chief Achieves Fame Amid Failures," Wall Street Journal (5/17) and "Fast Start Through The Insurance Minefield," California Journal (July).

Pension Plans: Examples of the coverage of the California issues will be found in USA Today (7/3), the Wall Street Journal (6/18 and 6/20), the New York Times (6/18), the Washington Post (6/18), and Business Week (7/1). Regan's views are summarized in the Wall Street Journal (9/13). Statistics on public pension plans are published quarterly by the Census Bureau in Finances Of Selected Public Employee Retirement Systems. The latest release was in September covering the quarter ending in December of 1990.

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STATE POLICY REPORTS

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The property tax is the least favorite tax of voters and elected officials. Yet its role is secure and its revenues are rising faster than other taxes. One reason is that the tax looks better when the alternatives are considered than when viewed in the abstract. Over the past decade, some states have substantially reduced property tax burdens but other states have increased them.

o Property Taxes p. 2

State officials are finding that it is difficult to consider the finances of state governments separately from those of local governments. Current issues in Maryland and New York illustrate the interactions. Helping Baltimore and New York City is an objective, but avoiding clear redistribution from the suburbs is a consideration.

o State And Local Fiscal Relations p. 11

State budgets have assumed stable federal policies and the spending levels reflected in last year's budget compromise. Despite recognition that the deficit will be larger than assumed and the Soviet military threat less than assumed, stable federal funding looks likely.

o Federal Policy And Grants p. 13

The state financial outlook is currently uncertain, primarily because the national economic outlook is uncertain. Risks to balanced budgets include health care and litigation. In the few gubernatorial elections this year, finances aren't a major issue.

o State Finances p. 15

Miscellany covers electronic funds transfer, measuring state exports, insurance regulation, kudos, pension benefits, public opinion, tax and spending limits, tax litigation, and Workers' Compensation. Technical notes detail data sources.

o Miscellany p. 19
o Technical Notes p. 23

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PROPERTY TAXES

Introduction, The Unpopular Tax: The property tax, as shown by an ACIR survey described in this issue, remains about the least popular tax. Elected officials often campaign on their concern about property tax burdens and their promises to do something about them. Many states have limited local property taxes for decades. A new wave of limitations began over a decade ago with Proposition 13 in California and Proposition 2 1/2 in Massachusetts. Many states have clones of these measures. Oregon's new Proposition 5 requires a gradual reduction of property taxes that is so massive that replacement revenue from the state is likely.

Property tax limits were active issues in some states this year. In Illinois, Governor Edgar successfully encouraged the legislature to adopt a limit for the suburban counties around Chicago. In Michigan, the governor (R) and legislative leaders (D) both offered competing limit proposals. Taking pressure off property taxes is one of the rationales for raising state taxes for public schools. This, combined with educational quality concerns, was associated with the tax passed by the Arkansas legislature this year, the popular vote in November on the tax increase adopted by the Missouri legislature, and the referendum this year on repealing the tax measure passed in Oklahoma last year. The New Jersey tax increases of 1990 were associated with property tax relief, school finance, and fiscal relief to distressed communities. This year some of the school money was reallocated to property tax relief in response to adverse voter reaction.

Yet The Popular Tax: Despite all this voter and elected official antipathy, the role of the property tax in government finance is increasing in many states. Higher property taxes are a consequence of cutbacks in state aid for local governments. They are often mandated by changes in school aid equalization formulas. The result of these changes is now, for example, beginning to appear in property tax bills in Kansas and Texas.

The property tax is often an easy tax to raise. Through the 1980s, values of existing properties rose more rapidly than inflation. These increases are, often with a lag, reflected in assessed values. In addition, the total assessed value was enhanced by new residential, commercial, and industrial construction. The standard limits on property taxes apply to rates, not to the tax base, so local officials found it relatively easy to capture 5-12% increases in revenues without raising rates and without bumping into limits.

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The result can be seen in the different rates of increase of the major state and local taxes as shown in Table 1.

Table 1: Relative Reliance On Three Major Taxes ($ billions)

Type Of Tax	CY1989 Revenue	CY1990 Revenue	Percent Change
Personal Income	$101.7	$106.2	4.4%
Sales	170.9	181.4	6.1%
Property	139.9	150.1	7.3%
Total, Three Taxes	412.5	437.7	6.1%

These current estimates (from the National Income and Product Accounts) suggest that if popularity is measured by increases in amounts raised, the property tax is the most popular tax, not the least popular.

Assessed Value Increases: Assessed value increases, not tax rate increases, are the key to increasing property tax yields in most jurisdictions most of the time.

Massachusetts local governments provide an example as they coped with a sharp downturn in the state's economy and declining state aid while limited in their use of property taxes by Proposition 2 1/2. It draws its name from what is often understood as a limit of 2.5% on property tax increases.

In 1990, Massachusetts local governments saw a cut of 8.5% in their state aid, which is about a fourth of their budgets. They nonetheless managed a 4.7% increase in spending by relying on an 8.3% increase in their property taxes and an 18% increase in fees and charges. In their 1991 budgets, they are increasing spending by 4.8% despite only a 3.5% increase in fees and a 5.3% additional cut in state aid. The key is a property tax increase of 7.5%. The property tax increases are primarily the result of added assessed value from new construction added to the rolcs, though there have been voter overrides of the Proposition 2 1/2 limits in some smaller communities.

Michigan and Wisconsin illustrate the inflation-beating changes in assessed values in the late 1980s. Both states lagged the nation in economic growth in that period, but showed changes in assessed values well above the 4-5% inflation rate. Residential property accounts for about 60% of total property values in Michigan and 62% in Wisconsin. Table 2 shows the annual changes.

Residential property values in Michigan have increased by nearly 10% in the last two years for which information is available. Other valuations, such as commercial and industrial, didn't rise as rapidly. Nonetheless, Michigan local governments could have increased their property tax revenues over 8% annually in the last two years with no increase in tax rates. In Wisconsin, the growth in the property tax base is slightly less dramatic, but still in excess of inflation. This is a major reason why holding down local property tax burdens is a major issue in both states.

Table 2: Percentage Change In Assessed Values, Michigan and Wisconsin

Year	Michigan Residential	Wisconsin Residential	Michigan Total	Wisconsin Total
1987	5.0%	2.8%	4.6%	1.0%
1988	8.1	4.5	7.2	3.9
1989	9.6	5.8	8.2	5.2
1990	9.9	6.8	8.8	6.1
1991	--	7.7	--	6.7

Assessed Value And Rates: Much of the politically salient excitement about property taxes is concentrated in situations where something unusual occurs. Increases of taxes on residential parcels in the 5-10% range aren't generally the source of tax limit movements. One such unusual event is the sudden jump in assessed values that result when there is a reappraisal after a long period of no reappraisals. This is the source of constant agitation in Cook County (Chicago and near suburbs) and of current controversy in the Atlanta area. In Georgia, as in some other states, taxpayers are notified of appraisal changes but don't know what their tax bill changes will be. The tax bills are set only after the total assessed value is known. So taxpayers may find themselves with a notification that their assessed value is up by, say, 50% and be told that their taxes won't go up 50%. However, no one knows how much they will go up.

The experience of many New England taxpayers is captured in the taxation of President Bush's home in Kennebunkport, Maine. In 1989, the First Family paid a property tax of 1.96% on an assessed value of $891,600. For 1990 taxes, their home was reassessed to a new value of $2.2 million, a whopping 146% increase. Not to worry, cautioned local officials, the tax rate will go down. It did, to 1.14%. That made the new tax bill $25,500, a tax increase of 28.5%.

Property Tax Approaches In 1991: Writing in State Legislatures (May) on "Easing The Pain Of The Property Tax" before most states had completed their legislative sessions, NCSL staffer Scott Mackey observed:

> As property taxes increase, so does the likelihood of property tax revolts like the one in Oregon. Lawmakers seeking to avoid them may be forced to raise other taxes to provide property tax relief to the middle class.

The jury is out on whether lawmakers in other states are willing to raise state taxes in order to reduce local property taxes.

Precise measurement of the impact of state budget decisions on local property taxes is difficult, if not impossible, even well after the fact. Local officials like to attribute their tax increases to state action or inaction. State elected officials like to attribute local tax decisions to local officials, even when they clearly aren't local, as in the case of the minimum property tax levy to receive state school aid. There is no referee for the competing claims. But in many states, the impact of the state action and inaction is clear. The results suggest no particular tendency in state policy.

State Taxes Relieving Local Fiscal Pressures: A few of the tax increases are likely to relieve pressures on local taxes even if not intended to produce that result. Examples are the school tax increases in Arkansas and Missouri and the new Connecticut income tax.

In other cases, the state relief isn't as dramatic, but state decisions will at least maintain funding levels, including inflation adjustments, for local activities. Local officials, however, won't necessarily see it this way. An example is California, where new local revenue accompanies responsibilities shifted to local government, and school funding is maintained at Proposition 98 levels, guaranteeing adjustments for enrollment and inflation. Vermont's large tax increase was designed to avoid sharp cutbacks that would otherwise have been necessary in many programs including local aid.

State Cutbacks Increasing Local Fiscal Pressures: Most of the states have put major pressures on their local governments, including school districts. In the Southeast, the cutbacks, which are continuing in FY 1992, were generally made administratively. The Alabama school cut, known as proration, is automatic. In North Carolina and Virginia, among others, decisions had to be made about how to allocate the cuts in FY 1991 enacted budgets and in FY 1992. Since the FY 1992 budgets were adopted, there have been major cuts announced in Florida, Georgia, and Maryland.

In the tight budgets of Midwestern states like Illinois, Indiana, Iowa, Michigan, and Minnesota, there was essentially no new funding for local governments except small increases in school aid. Many of the relatively autonomous local governments in these states will respond with higher taxes.

The most dramatic pressures on local taxes will appear in Massachusetts and, to a lesser degree, New York. Both have extensive local aid programs beyond their support of public schools. Both avoided large tax increases by cutting some of these programs below the level of prior years and providing no growth in others. These and the equalization states (see box) will likely see the most rapid property tax increases.

How Equalization Raises Property Taxes: The essence of school finance equalization is to cause per pupil spending among districts to be more equal, assuming equal local tax rates. The most expensive way to do this is by adding state aid to districts with the lowest tax base, but the costs of sole reliance on this method have been too much for every legislature. So some tax base must be taken away from richer districts and, in effect, redistributed to poorer ones.

There are lots of ways to do this. With tax base sharing -- long in effect in the Minneapolis area and newly adopted in Michigan -- some tax base is shared regionally. In Texas, new taxing districts combine formerly rich and formerly poor school districts for property tax purposes. In most states, raising the local effort factor also achieves redistribution. That factor is automatically increased more for rich districts than for poor ones because it depends on the size of the local tax base. Because the factor is a deduction from school aid that would otherwise be paid, raising it cuts the aid most for the most affluent districts.

No matter how the wealth is redistributed, it results in more school spending in the poor districts. It will produce less spending in the affluent districts, unless something is done. The state may not cushion this effect completely through increased aid. The result, now causing considerable concern in Dallas area school districts, is some combination of program cutbacks and higher local property tax rates.

Special Forms Of Property Tax Relief: Many states have property tax relief programs. They come in several distinct forms with differing effects.

Simple limits on property taxes with no replacement revenue from the state are common. Proposition 13 in California and the new Illinois limits are examples. Many issues associated with these limits are unique to each state and limit. In California, there is constant litigation over what kinds of revenue-raising measures are exempt. In Illinois, there was controversy this summer over a rush of local borrowing designed to get the resulting property tax for debt service into the base before the limits on increases went into effect. In Massachusetts, there is controversy over details of Proposition 2 1/2 enforcement. Concerned with the impact of state cutbacks on local finances, the legislature loosened some restrictions. Concerned with taking the property tax decisions from the voters and putting them in the hands of local elected officials, the governor vetoed the bill.

A recent study compared property tax changes in states with limits of various types and without limits. It suggests that some forms of limits, particularly those controlling both assessed value and rates, have been effective in keeping property taxes lower than they would otherwise be. They also tend to hold down local revenues, but not as much as they hold down property taxes. Revenue raising pressures appear in other taxes or fees when property taxes are limited.

Some state decisions provide relief for one group of taxpayers at the expense of another by deviating from uniform tax rates. One method is the classification of property so that, for example, residential property pays a different rate than commercial property. This usually occurs by having assessments of different classes of property be differing percentages of market values.

Classification issues dominated the statewide elections in Kansas in 1990 and remain a knotty problem. Legislators there, as elsewhere, constantly rediscover that they can't help one group of property taxpayers without increasing taxes on another. The issues often interact with state constitutional provisions and the federal "4-R" legislation barring discrimination against certain forms of transportation. The result can be a complex and nearly intractable mess, which describes what Nebraska legislators faced this year. Another form of relief comes by exempting a portion of assessed value from property taxes through homestead exemptions. There was considerable discussion of this topic this year in several states, but little action.

There are also special provisions of state income tax laws that are designed to offer property tax relief. One is circuit breakers which offer targeted relief. The targets are the elderly and/or low income persons with relief in the form of tax credits generally based on the extent to which property taxes exceed a stipulated percentage of income. Broader relief is offered by a few states in the form of special decisions in the state income tax for property taxes paid. New Jersey eliminated one of these in its 1990 reform package. Illinois converted its special deduction to a more restrictive credit in this year's action.

Who Pays Property Taxes? There is general agreement among tax analysts that residential property taxes are regressive, representing a higher proportion of income for low income taxpayers than for higher income tax payers. A typical study result was presented at a Maryland tax policy conference earlier this year. Estimates for the three major taxes are shown on Table 3. While calculated from 1987 data, they should approximate 1991 burdens.

Table 3: Maryland State And Local Taxes As Percentage Of Income

Income Class	Property	Income	Sales
0-5,000	9.4%	0.8%	11.2%
5,000-10,000	2.8	1.7	4.1
10,000-15,000	3.1	2.9	3.7
15,000-20,000	3.0	4.2	3.2
20,000-30,000	2.9	4.4	2.8
30,000-40,000	2.7	4.4	2.6
Over 50,000	2.1	4.4	2.0

The simple reason why lower income people find property taxes a higher proportion of their income than higher income people is that they spend a higher percentage of their income on housing. However, the regressivity may not be quite as serious as some studies suggest.

Property Tax Revolt? While the property tax is widely disliked, there don't appear to be nationwide signs of a property tax revolt comparable to the wave of initiatives and legislative actions that followed Proposition 13 over a decade ago.

One major reason is that property tax burdens, on average, haven't been increasing. In the 1960s, property taxes took around 4% of personal income, which rose to 4.4% in 1972. They had dropped to just over 3% by 1982 and remain there today.

Another major reason is that many voters don't have a method for translating concern over property taxes into a statewide policy because they don't have access to initiative and referendum. Michigan and Oregon show the contrasts. Both states rely heavily on property taxes for schools. In both states, experts, teachers and other school personnel, and most elected officials of both parties view higher reliance on the sales tax and lower property taxes as appropriate state policy. In both states, property taxes are high as is voter resentment of property taxes. In both states, voter resistance to property tax levies is high in local elections. In both states, state leaders have presented propositions to the voters that promised lower property taxes at the price of sales tax increases (Michigan) or adopting a sales tax (Oregon). In both states, voters have rejected these measures.

There the resemblance between the two states ends. Michigan officials continue to seek to outpromise each other with property tax relief plans, but there has been little change. With initiative a popular mechanism for many purposes, Oregon voters adopted a property tax limit and a mandate that the state raise the revenue that local governments will lose. The net effect will presumably be, sooner or later, a new Oregon sales tax.

High Property Tax States: There are several answers to the question of which states have the highest property taxes. Each of the relevant concepts is used to rank states in States In Profile: property tax revenue as percentage of revenue from the three major taxes (Table D-3), per capita property taxes (Table D-7), property taxes in relation to personal income (Table D-9), and property tax burden under the representative tax system (Table D-21).

In the latest year for which data are available (FY 1989), property taxes ranged from 6.6% of income to 1.2% with a national average of 3.5%. Each of the highest ten states has its own property tax story, but there are some common themes. The two states with the highest burden -- Alaska (1) and Wyoming (2) -- get their rankings from taxes on resource industries, particularly oil and gas. There is little pressure for change. New Hampshire (3) has high property taxes despite low public spending because it doesn't use sales or income taxes. Residential property taxes are particularly burdensome for long-time low income residents whose property values rose with the state's prosperity while their income didn't. Relief targeted to them is difficult because the only source of funding is yet higher property taxes for other Granite State property owners. This leads to pressures for an income or sales tax in New Hampshire. For the same reason, the solution to high property taxes is seen as adopting a sales tax in Oregon (4) and Montana (5).

Many other states with high property tax burdens in FY 1989 have taken action to reduce pressures on property tax funding. Vermont (6) raised practically every state tax this year. New York (7) raised state taxes in 1990 and 1991, but not enough to avoid property tax increases in New York City and in suburban counties. New Jersey (8) increased sales and income taxes in 1990 and provides state checks for property tax relief. Nebraska (9) passed a comprehensive package raising sales and income taxes explicitly to relieve property tax burdens. Michigan (10) hasn't acted, which is why property tax relief is a major issue there.

States Increasing Property Taxes: For taxpayers, the changes in property tax levels may be as important as the absolute levels of property taxes. The most appropriate measurement of change is probably to compare property taxes over time on an identical home. With these data unavailable, the closest proxies are changes in per capita property taxes and property taxes as a percentage of personal income. The comparison, which appears in Table 4 for selected states, combines taxes on residential, commercial, utility, and other property. Even though two states increased property tax burdens at the same rate, one may have increased residential property burdens much more than the other.

Table 4: Percent Change In Property Tax Burdens, FY 1979-1989

State	Per Capita	Percent Of Income
New Hampshire	148%	-6%
Virginia	143	6
Louisiana	138	28
South Carolina	134	15
Texas	123	16
Florida	122	1
Connecticut	120	-15
Oregon	117	16
Georgia	112	-6
Minnesota	112	0
New Jersey	109	-17
Wisconsin	105	-1
Alabama	104	0
California	104	-2
Michigan	103	4
Pennsylvania	103	-2
United States	**95**	**-8**
Arizona	70	-18
Delaware	67	-18
South Dakota	59	-14
Idaho	58	-14
Missouri	55	-26
New Mexico	37	-28
Massachusetts	36	-48
Nevada	9	-42

The percentage increases in per capita amounts don't have consistent relationships with the increases in amounts related to personal income because per capita income growth varied considerably among the states in the decade covered by the table. With rapid income growth, New Hampshire had the nation's leading increase in per capita property taxes but managed to reduce property taxes in relation to personal income. But the other states with high per capita increases show increases in the second column as well.

The Outlook: There doesn't appear to be a clear-cut trend among the states in dealing with property taxes. In terms of broad patterns of local finance, some states are continuing a trend of increasing the state share of total costs, raising state taxes as necessary to achieve this result. But other states have been curtailing local aid, a trend that may persist beyond the recession. State-funded local property tax relief also presents a mixed picture. Sometimes the picture is even mixed in a single state. Maine has adopted several relief measures over the past several years, but retreated from some in the face of fiscal adversity. One question is "Property Tax Relief Mechanisms: Should States Get Out Of The Business?" which Therese McGuire posed in the Government Finance Review (June). Her answer:

> There thus appears to be no magic solution to high property tax burdens. Each of the property tax relief mechanisms has its imperfections. The very concept of state involvement in the fiscal affairs of local governments is challenged here through an interpretation of economic models and evidence. As states continue to evaluate and reform their fiscal systems in the decade to come, the link between state and local governments provided by property tax relief mechanisms will be an important area of potential reform and change.

The property tax has few advocates among citizens, academics, or elected officials. Its popularity in practice is based on the fact that state and local officials often can't think of a better idea in their particular time and circumstances. The property tax is often also the "default" in public finance choices. For example, state officials agree with enthusiastic support of educators that the state share of public school costs should be increasing. The policy substitutes state income and sales tax revenue for local property tax revenue as well as leading to more spending. But when fiscal stringency and other priorities cause state aid to be cut or increase less than school spending increases, the role of the property tax increases by default.

Sharply diminishing the role of the property tax isn't easy, as elected officials in Michigan and Oregon have found by taking propositions to voters to increase sales taxes in order to reduce property taxes. Abolishing the property tax entirely raises a host of difficult problems, as the British discovered when they substituted a per capita community charge (which critics call a poll tax) for their local property taxes. The change has been unpopular since being introduced last year. This spring the system was changed by reducing the community charge and making up the revenue by increasing the value added tax and certain excise taxes. A new system reinstating property as part of the tax base is expected to be announced before nationwide elections, which must take place before next summer.

If property taxes are to remain the mainstay of local government finance, state officials may get more serious about the state-controlled procedures determining property tax administration. There is a substantial reform agenda with little dispute among experts on what the agenda contains and plenty of states following apparent best practices. A recent report in Indiana indicates the kinds of changes that can be made. An example is providing a reasonable number of separate officials to control assessments. Some states make the function a county one so California has 58 jurisdictions involved, Florida and Pennsylvania have 67, and Ohio has 88. But less populous Indiana has 1,008 -- lots but not as many as North Dakota with 1,721 and Wisconsin with 1,837.

STATE AND LOCAL FISCAL RELATIONS

Fiscal Realignment In New York: Concern about state-local finances in New York has an urgency not present in most states because of the seriousness of the problems and thus their tendency to reappear frequently. The underlying problem is that state and local spending is well above the national average while personal income isn't. This means that tax burdens are high, so high that there is greater than normal reluctance to raise taxes, state or local. As a result, it is more difficult for the state to deal with central city problems by absorbing functions or costs than in most other states. Conversely, there are greater limits on the state's ability to solve its fiscal problems by pushing them to local governments than in some other states.

In this context, state and city officials haven't found dramatic solutions for the impact of the economic downturn on the state and particularly on New York City. This year the state cut some of its local aid and raised taxes. New York City announced various austerity measures, not all implemented, and raised its taxes. The city's long term fiscal plan calls for further increases in taxes, including property taxes. Key city business leaders have been calling for more austerity and a four-year moratorium on city tax increases.

Splitting Medicaid costs with the state is one New York City burden not carried by other major cities, even the ones that like New York have county as well as municipal functions. There has long been interest in shifting these costs to state government, as has occurred in most states. The principal barriers are the ones to shifting any local function to the states. First, the state can't afford it. Second, the fiscal relief afforded local areas would be much greater in some areas than others. In this case, suburban tax payments to the state would defray much of the cost while much of the fiscal relief would be concentrated in the cities. Recently the governor announced a long term plan for dealing with the situation. Medicaid costs would gradually shift to state government. So would local taxes to pay those costs. For New York City, this would presumably include a significant part of the local income tax. For at least a while, the state would be collecting higher income taxes in the city than elsewhere in New York.

Tax Policy And Fiscal Disparities In Maryland: Maryland's state-local fiscal relationships provide the same types of policy choices but are more easily understood because the state of 4.5 million people concentrates local responsibility in 23 counties and one independent city, Baltimore. These local governments carry responsibility for schools as well as major local functions.

Maryland has experienced the same fiscal problems as other East Coast states. A blue ribbon tax policy commission made its recommendations available for this year's legislative session. Unlike recommendations of most such groups, it did not suggest revenue neutral changes and offer suggestions for what tax to raise if the legislature opted to raise taxes. Instead, it recommended more spending and taxes, including specifying the amounts. The legislature opted to avoid major tax increases in its spring session. Now it appears that revenues are running well behind the estimates associated with the enacted budget. The governor has announced a series of austerity measures including laying off over a thousand employees, but hasn't implemented them until he completes discussions with legislative leaders. It's fairly obvious that, given his choice, the governor would like to see a substantial tax hike.

Maryland has the same types of grants to local government that are found in other states. It also has a unique piggyback local option income tax. All local governments have exercised the option which gives Maryland what amounts economically to a graduated personal income tax with one-third of the income going to the county of origin.

Part of the research done for the commission was a study of the spending needs and tax base of the counties. Done by the Advisory Commission on Intergovernmental Relations, it reflects ACIR's concepts of representative tax and expenditure systems for states, only applied at the local level. The results are expressed as a percentage of the statewide average in Table 5.

Table 5: Fiscal Capacity and Need Of Selected Maryland Counties, 1988

Type Of Jurisdiction	Tax Capacity	Needs	Net Local	Net w/ Grants
Industrial Enclave (Calvert)	166	92	181	154
Affluent Suburb (Montgomery)	156	88	178	144
Statewide Average	**100**	**100**	**100**	**100**
Poor Rural (Allegany)	71	100	71	86
Central City (Baltimore)	57	142	40	69

The first column shows the wide variation in tax base with Baltimore having only 57% of the state average. The second column shows the disparities in "needs" measured by such factors as the percentage of population in poverty and number of public school students. The affluent suburb has needs relatively close to, but below, the statewide average while Baltimore exceeds the average by 42%. The third column relates the first two. One way of looking at it is to conclude that the suburban county is 81% better off fiscally than the state average while Baltimore is 60% below average. The fourth column is another version of the third column, adjusted to reflect the impact of federal and state grants. The grants (including federal programs phased down or out since 1988 when the data were collected) reduced the disparities, but clearly didn't eliminate them. State grants subtracted 19 points from the tax base of the suburb, 16 from the enclave, but added 9 points to the poor rural county and 20 points to Baltimore.

The difficulty for Maryland legislators is to coordinate their tax policy adjustments with their state-local fiscal adjustments while producing a package that is feasible to enact. Raising the income tax would produce much more piggyback revenue for the affluent communities than elsewhere. But a solution that broke the piggyback link for the added increment of tax would make clear that much of its revenue would be raised in some counties to be redistributed to others. The school aid formula can also play a role in shifting purchasing power, but there are hazards. Many of the adjustments in school aid (e.g., putting teacher retirement in the school formula rather than paying it separately) are the types of changes enacted in New Jersey in 1990 and reconsidered in 1991 after strong opposition appeared.

FEDERAL POLICY AND GRANTS

Federal Grant Appropriations: The Congress failed to enact appropriations for many programs before the October 1 beginning of the federal fiscal year. This doesn't matter much as continuing resolutions will provide interim funding. There is little controversy over appropriations for grants, so last minute surprises upsetting state budget planning are unlikely except for Medicaid bootstrap financing regulations.

Led by Medicaid, set to grow 16.2% in FY 1992 in both House and Senate legislation, federal aid is likely to grow by over 10%. This is well in excess of the growth rate in state and local tax collections and well in excess of likely inflation.

Federal Deficit: The budget compromise legislation from last year will result in much larger deficits than contemplated when it was passed because of the economic downturn and various misestimates. The resulting deficit in FY 1992 will add over $1,000 per capita to the federal debt. This doesn't seem to be a cause for widespread concern inside the Beltway. As a result, the outlays contemplated by the compromise, those assumed in state budgets, are likely to be made. FFIS (see Technical Notes) suggests that neither party is interested in amending the basic budget legislation until after the 1992 elections, so "it is therefore expected that smoke and mirrors will be employed to a fairly significant extent in the 1993 budget."

There is one problem. The legislation was designed to provide enough borrowing authority (debt ceiling) to get through the 1992 elections without voting more. But higher deficits mean more borrowing, perhaps so much more that debt ceiling legislation will be required. Votes on that legislation usually produce debates and amendments on the budget process and sometimes on overall spending levels.

The debt limit debate could provide an occasion for cutting the federal programs on which state budgets depend. On the other hand, the argument is being made that changes in the international situation and Soviet military capabilities and intentions permit a sharp contraction of the defense budget. Opening the budget agreement with that logic would turn the debate to higher federal domestic spending in such areas as education and health care.

Funding Formulas: The federal Medicaid formula will be allocating about $80 billion among the states in FY 1993 for Medicaid,. AFDC welfare assistance, and child care. The formula governs only the sharing of costs between the states and the federal government. The states determine how much is spent in total, within guidelines that aren't very restrictive and state budget constraints that are. The formula is applied to that total cost.

By using the square of per capita income to magnify disparities among states, the formula is designed to: (1) provide much larger federal shares to poor states than more affluent ones and (2) adjust automatically to changing fortunes of individual state economies. Without any other factors, the formula would provide a federal match of 15% of Connecticut's costs and 20% of New Jerseys, on the low end, while covering 79% of cost in Mississippi and 76% in West Virginia. However, there is a 50% minimum federal share.

New per capita income data will affect the FY 1993 percentages. Large gainers are states where the 1990 Census sharply upped population estimates and thus dropped per capita income estimates. The biggest gainer is Arizona, where 3.3% of total Medicaid will shift from state to federal funding. There will be lower federal shares for 29 states led by Nebraska and Hawaii.

Despite matching percentages favoring poorer states, more affluent states typically get the largest per capita Medicaid payments because those states have larger and more costly programs. They typically have more generous eligibility criteria, cover more services, and have higher reimbursement rates for doctors and hospitals.

STATE FINANCES

Fiscal Conditions: The state fiscal outlook remains in doubt as each month's tax collections, national economic statistics, and forecasters' shifting views are examined to see where each stands.

The situation is considerably different than it was a year ago. Then just about every state was starting to get bad news as revenues were running below estimates. This year the estimates are more pessimistic and the economy isn't losing ground, or at least not as much ground as last year. As a result, the relationship between estimates and actual collections isn't the shortfall of last year but a combination of shortfalls and surpluses on a month to month basis. The situation of each state depends on: (1) how optimistic/pessimistic the revenue estimates are and (2) how well/poorly that state's economy is performing relative to the national economy. Uncertainty is the overriding characteristic of state views of the fiscal outlook.

There is no uncertainty about FY 1991 which ended in June for most states. The returns are in and weren't good. This means states have ground to make up in FY 1992 that wasn't expected when the FY 1992 budgets were enacted. The mechanisms are complex, but making up for FY 1991 shortfalls will have the first call on any unexpected revenue in FY 1992. Also, the budget assumptions of many states are being challenged by the potential federal regulations on Medicaid bootstrap financing. If the regulations go into effect as scheduled, they are bound to result in added demands on budgets of the affected states. Some will probably react by substituting new taxes on health care that are consistent with the regulations for special taxes and donations that aren't consistent.

Data are insufficient to suggest a median situation for states that raised taxes, but **Reports** suspects North Carolina, whose situation was recently estimated by the legislative fiscal office, may be it. Collections for the first two months of the fiscal year were slightly over estimates. But to deal with FY 1991 problems, some refunds weren't made until FY 1992. Combining the good news on current collections with the bad news from the prior year, revenues are "essentially on target." The assumed growth in FY 1992 revenues is 4.5%, well below the 7.5% that represents normal growth. This means that the state should be able to operate in the black even with a slow and weak national economic recovery.

The outlook is much tighter for the states that didn't raise taxes. They had less cushion to absorb the FY 1991 year-end revenue shortfalls. They probably left less room for error in their FY 1992 revenue and spending estimates. The results are special legislative sessions to cut spending (e.g., Georgia and Maryland), administrative cuts (Florida and Iowa) and consideration of major changes that haven't yet resulted in action (Colorado and Tennessee).

Also worth remembering: many states left loose ends in their FY 1992 budget action. Examples are employee compensation in California and Connecticut and health insurance and general assistance in Massachusetts.

As a result, there is considerable potential for late 1991 and especially early 1992 to present many state fiscal situations nearly as bad as those of 1991. The serious problems would be concentrated in the states that didn't make major fiscal revisions in 1991 by tax increases and spending cuts. But the reverse possibility shouldn't be ignored. The North Carolina analysis reminds readers of the rapid growth that followed the last recession. The growth forecasted for FY 1984 was 8%, but the state realized 12% growth because of the rapid recovery. A recovery of that magnitude might even revive consideration of tax cuts -- the forgotten topic of state finances -- in at least a few states.

Elections: Most states hold statewide elections in even-numbered years. The few exceptions with elections this year won't shed any light on tax policy, spending levels and priorities, economic regulation and other money issues of state policy.

The Mississippi race pits Governor Mabus against a Republican challenger. The big news the transition to a two-party situation, rather than having the choice be among Democrats. Mabus continues to take the positions he has for years. Elementary and secondary education is the key to the state's development, but must be funded without new taxes. This means a lottery, oft rejected by the legislature, and unspecified other non-tax revenue measures. His opponent is pro-development and anti-tax, without much detail.

In Kentucky, Governor Wilkinson can't run again. With the state still absorbing the complete rewrite of its education and tax laws of several years ago, the candidates are also pro-education and anti-tax without much detail. They do have details on tax burdens they would like to eliminate. For both, this includes the income tax on private pension income and the inheritance tax (presumably excepting the portion that has an offsetting credit against federal tax). Both have ideas that reduce the burden of the severance tax on coal.

The Louisiana race has received the most national coverage because of the personalities involved. Former Governor Edwards lost to Governor Roemer in the 1987 primary when both were running as Democrats. Edwards falls in the tradition of Louisiana populists including a strong political base among the poor and a flamboyant personal lifestyle -- many indictments but no convictions, love of gambling, colorful language.

Roemer came from his Congressional seat into a 1987 campaign that caught national attention because of self-imposed limits on campaign contributions, a determination to clean up state politics, and a technocratic-yuppie style that appealed to the nation's journalists. Early in his term, he pushed a variety of reform measures including a major tax reform package and extensive solutions to the state's then-serious fiscal problems. The tax reform included greater reliance on taxes on individuals (particularly income and property taxes) and less reliance on business taxes. The overall thrust of the plan was defeated -- in part by the legislature and in part by voters dealing with parts requiring constitutional amendment. Instead, the sales tax was extended to food and utilities. This solved the state's fiscal problem but left the tax system more regressive than before reform was proposed.

Roemer switched affiliation to the Republican Party, but the state party machinery didn't switch to him. It endorsed U.S. Representative Clyde Holloway. But the President and other national Republicans are backed Roemer. Then there is David Duke, who is viewed by the national media as standing for racial resentment. He is also a Republican. The October 19 primary narrowed the field to Duke and Edwards.

The common characteristic of all three races is the absence of discussion and debate oriented to fiscal issues.

Paying For Health Care: Federal action that might relieve state health care financing problems won't be forthcoming soon. In a recent Congressional hearing, Bush Administration officials were critical of a variety of proposals, but didn't offer one of their own. Budget Director Darmon talked of the possibility of a signing ceremony for a plan, but only in President Bush's second term. This would mean mid-1983 at the earliest. House Ways and Means Chairman Rostenkowski also offered criticisms of pending proposals.

Meanwhile, Medicaid costs are increasing by 15-20% a year with no relief in sight. The elements affecting cost per recipient are: (1) the unit prices prevailing in health care, which are rising faster than inflation, and (2) the units of care provided, which are a function of medical technology and medical practice which continue to evolve in the direction of more tests and more procedures. The number of recipients has some built-in long term growth because of increasing numbers of persons needing nursing home care and because of federal mandates regarding children and low income persons also receiving Medicare. The most positive possibility is that an improving economy might take some people off welfare, and thus off Medicaid.

California's situation, as recently portrayed by the Commission on State Finance, is indicative of the situation nationwide. Adjusted for accounting system changes, Medi-Cal will cost $4.7 billion this fiscal year, an increase of 17% over FY 1991. About 7% of the cost increase is associated with an increase in the number of recipients and 10% with an increase in the cost per recipient. The Golden State is moving to managed care though more slowly than New York which is moving as rapidly as it can to associate every Medicaid recipient with a primary care provider who determines the need for other services.

The Commission identified problems that could cause FY 1992 spending to be higher than appropriations. One category, found in many states, is savings from reforms that will not appear. In California this year they are: (1) a family planning program not likely to help much in FY 1992 because the babies affecting the fiscal year health costs will have been conceived before the program reaches and mothers and (2) a plan for recipients to charge fees of 50 cents to $3 as copayments. The legislature eliminated the copayment requirement from the budget legislation, but didn't eliminate the savings.

The Commission identifies "program pressures" that could cause overruns in FY 1992 totalling $1.14 billion or 20% of the Medicaid budget. One is federal disallowance of Medicaid bootstrap financing, where California is at less risk than some other states. The second comes from nursing home regulations adopted in the 1987 federal budget legislation. California has been in a dispute with federal officials on this topic with early estimates of state costs of $300-400 million. The Commission scaled down its estimate of risk to $100 million, over and above the $14 million included for this purpose in the budget legislation. Finally, there is litigation on reimbursement rates for hospitals and other providers. Following a U.S. Supreme Court decision that providers could sue and the July victory by hospitals in an action against the State of Washington, the California Association of Hospitals and Health Systems sued the state. The Commission estimates $100 million of risk to the Medicaid budget in FY 1992 (more in later years) and comments.

> If decided against the state, this suit could require substantially higher reimbursement rates for outpatient services. Moreover, the ruling could set a precedent for other Medi-Cal providers, such as physicians and laboratories, to file suit for higher rates as well.

Judicial Budgets: The chief justice of the New York supreme court announced he was beginning litigation against the governor (and presumably the legislature). The judge's complaint isn't unusual. He doesn't like the budget for the court system, which is producing about 500 layoffs in the lower courts that he expects will exacerbate backlogs in the judicial system and further encourage the use of plea bargains in criminal cases. The courts are not the only public agencies to complain about their budgets, but the only one to sue. The governor and legislative leaders of both parties responded that they thought the courts had been adequately funded. The governor's initial comment was, "First I'm going to laugh, then I'm going to take it seriously." Experience in other states suggests the governor is right in both reactions.

State constitutions, including New York's, clearly contemplate that no agency shall be able to spend public funds except pursuant to appropriations made by the legislature. This concept doesn't have any exceptions -- not for governors, not for the courts, not even for the legislature itself. The idea that the judiciary would set its own budget by litigation that it would both bring and decide smacks of irregularity.

But there are precedents. The chief justice counts 14 other states which have had such cases, with the result being orders for higher appropriations in some. The most compelling cases arise when the legislature provides no appropriation at all for a function mentioned in the constitution, such as the salary of an elected treasurer or comptroller. The legal going gets tougher when the hassle is over the amount rather than the existence of an appropriation.

MISCELLANY

Electronic Funds Transfer: Electronic funds transfer is becoming common for individuals who use it when they have paychecks and Social Security checks deposited automatically, use bank automatic payment plans for utility and other bills, and use debit cards like those that come with brokerage firms' cash management accounts. States use it in their employer role, in investment and cash management transactions of treasury and pension funds, and probably elsewhere. Experiments are under way to use the procedure for cash welfare payments. Other things being equal, the procedure saves considerable paperwork, and thus cost, associated with use of paper checks.

Other things are not equal when substantial "float" is involved. For example, when a tax payment is due on the 15th of the month, payment by check will not result in a cash outlay by the taxpayer until the 17th to 19th. Symmetrically, the state doesn't get the use of the money until those dates. In that context, requiring electronic funds transfer means cash on the 15th, thereby accelerating the receipt to the state and effectively accelerating the due date of the tax. For this reason, shifting to electronic transfer has revenue effects. An increasing number of states are shifting to EFT as indicated by a survey of state tax agencies.

Exports: Stimulating exports is a key part of the economic development strategy of practically every state. The obvious test of these programs is whether exports are increased. But measuring exports isn't easy. A recent study assesses the two available measures and finds they produce quite different results. For example, one measure makes California exports 32% higher than the other while Connecticut exports are shown to be 35% lower. For smaller states, such as Nevada and Wyoming, one series estimates exports twice as high, or more, than the other. The ideal solution, according to the Federal Reserve Bank economist who did the study, is a third series that would measure value added in each state.

Insurance: The well-publicized insurance company failures seem to be producing more nationally uniform regulation of insurers and guarantee funds, though how the system will evolve is in doubt. Some Members of Congress are pushing federal regulation, but their criticisms of state regulatory failures are getting more publicity than votes. The state regulators and most of the industry are opposed. With the bad news about federal regulation of banks and S&Ls continuing, some are skeptical about turning insurance regulation over to the federal government.

State regulators and the industry are attempting to clean up their act. The National Association of Insurance Commissioners has model legislation and is considering other actions such as multi-state guarantee funds. There are extensive efforts to combine state guarantee funds and private company investments to resolve the situation of failed Executive Life policyholders.

Kudos: Governor Wilson's handling of California budget problems has been reviewed by many newspapers and magazines, typified by the Wall Street Journal (9/20). The governor gets credit for a fiscally successful resolution of a difficult budget problem with a budget the Journal called "a model of balance and political acuity." However, national observers predict problems ahead. Some are political, as the budget solution alienated many conservatives with its heavy emphasis on tax increases. Some are non-fiscal issues to come. including subjects from gay rights to water policy. Less emphasized in the coverage is the evolving fiscal situation. The budget, like those of other states, presumes national economic recovery starting in July of 1991 and continuing through FY 1992. Longer term, California's ability to fund its current services depends upon the state maintaining the pattern of the 1980s with economic growth consistently about a percent above the rest of the nation.

Pension Plans: The National Conference of State Legislatures has recently completed a compilation of state pension plan provisions covering regular and state police employees. It shows the benefit formulas for each type of plan for each type of employee. Some representative benefit levels are shown in Table 6.

Table 6: Typical Pension Benefit, Employee With Identical Salary Histories, 1990

State	Regular	Police
California	17,078	17,078
Florida	12,506	15,633
Georgia	13,423	16,369
Illinois	14,041	20,280
Michigan	11,947	24,554
New Jersey	13,353	19,989
New York	13,273	19,989
Pennsylvania	15,991	21,348
Texas	15,991	19,989

Public Opinion: The Advisory Commission on Intergovernmental Relations has been sampling public opinion on fiscal issues for nearly 20 years. The newest survey shows little change in the last several years on key fiscal questions. When asked to identify "the worst tax -- that is, the least fair," 14% of respondents offered no opinion on which was worst. The big losers were the local property tax (30%) and the federal income tax (26%). The state sales tax drew 19% and the state income tax 12%.

Respondents were asked which level of government spends their tax dollars most wisely. Ten percent said they didn't know. A whopping 27% deviated from the suggested choices to say than none did and 2% volunteered that all did. Among the answers on the list, local government got 35% approval, followed by states with 14% and the federal government with 12%. An obvious inference from this result and the tax preferences is that state governments should use sales and income taxes to put money in the hands of local government to relieve pressures on the property tax.

Tax And Spending Limits: Many states have statutes or constitutional provisions designed to limit the growth of state taxes or spending. There is considerable interest in some states, such as Connecticut, in adopting such restrictions. Some of them, such as the Gann Amendment in California and the Hancock Amendment in Missouri, have had major impacts on state fiscal decisions. Many do not because they are statutes that can be superseded by other statutes or constitutional provisions with opportunities for the legislature to exceed the limit by declaring an emergency.

The Texas constitutional limit passed by voters in 1978 limits budget growth to the growth in the state's economy as determined by the budget board of the legislature. The legislature can avoid the restriction by a resolution finding that an emergency exists. The new Texas biennial budget calls for growth of about 17%. The economic growth rate underlying the revenue estimates is 12-14% depending on who is talking. The legislature didn't declare an emergency to comply with the exemption. Therefore, the budget is illegal according to a group called Taxpayers Against A State Income Tax, which expects to start litigation to invalidate the budget. Legislative leaders don't see a problem because the budget board never formally adopted a growth assumption in the last legislative session. So, the new legislature didn't have to follow one because it couldn't do the work a prior legislature failed to do.

Tax Litigation: The U. S. Supreme Court has agreed to decide several cases of considerable importance to state finances. The cases are likely to be decided before the completion of the court's term that ends next summer.

One case concerns mail order sales. Under a 1967 Supreme Court decision, states cannot require mail order sellers in other states to collect their sales/use taxes. As a practical matter, the states can't collect directly from the buyers either, though they are legally liable for a use tax. The revenue loss is $2-3 billion nationally. Many states -- the National Governors' Association counts 34 -- have enacted legislation designed to push the limits of the old decision as far as possible. The result has been considerable litigation. In one of the cases, the North Dakota Supreme Court upheld a state law by concluding that the 1967 Bellas Hess case was no longer operative. The U.S. Supreme Court's decision to take that case is a decision to review the 1967 holding.

A decision favorable to state taxing power would result in an immediate infusion of revenues for states. It would also create a need to decide how to handle the many different local sales taxes that exist in some states. Mail order houses claim that it is difficult for them to collect these taxes. One alternative is for states to establish a blended rate for local taxes, as Missouri has done. The blended rate is a feature of legislation pending in

Congress that is designed to do about the same thing as the North Dakota decision. That legislation appears to be on hold because representatives of states and local government haven't been able to agree on the handling of local taxes.

The second case concerns situations in which comparable properties are assessed (and thus taxed) at sharply differing levels. Under the laws of practically all states, the assessments are supposed to be comparable. Often they are not for administrative reasons, such as a tendency of assessors to update assessments when property is sold without updating assessments of similar property that doesn't change hands. In a landmark case several years ago, the U.S. Supreme Court decided that such practices can violate the U.S. Constitution. In California, the discrimination is an intended consequence of Proposition 13's tax limiting provisions. When property is sold, assessed values are changed to reflect market values. But before property changes hands, the property tax increases are limited. As a result, comparable business and residential property can have sharply differing taxes. Under pressure of a possible boycott, Macy's pulled out of its California case, but a homeowner continued to push the issue, resulting in the U.S. Court's decision to hear arguments and decide the case.

Workers' Compensation: Concerns over the rising costs of Workers' Compensation (WC) are increasing as WC payroll taxes increase. Attempts to limit costs helped delay budget deliberations in California and Maine. Even though WC issues aren't usually in budget bills, Governors McKernan and Wilson sought to tie cost-cutting in WC to cost-increasing tax measures. Little change was made in either state. In Maine, Governor McKernan (R) called off a planned fall special session on the topic after meeting with legislative leaders (D) in what he called "a very unpleasant and short conversation." He concluded the session would be a waste of taxpayers' money.

The subject won't die in these and other states. Benefit increases often lag inflation, making the topic an urgent one for organized labor and creating sympathy among lawyer-legislators who realize that benefits to injured workers in the no-fault WC system are much less than those paid ordinary citizens in tort claims for the same injuries. While labor is dissatisfied with benefits, management is dismayed by growing costs. With corporate profits down and WC costs up, WC taxes often exceed corporate income taxes for manufacturing companies. A steep premium increase gets attention fast, as recently happened in Pennsylvania.

Workers Compensation coverage is mandatory in most situations, though Texas has some glaring examples of exceptions. In some states, the coverage is only "sold" by the state, so the WC payment is a tax. In some states, the coverage is from a private insurance carrier with state-regulated rates and benefit schedules, so the WC payment is a "premium." In both cases, it is a state-mandated payment with the effects of a tax from the employer's perspective. Premiums paid to private companies and the benefits paid by them aren't state funds. WC taxes and benefit payments are state funds, but aren't general funds subject to appropriation. As a result, WC issues aren't a part of the normal budget deliberations. But WC, unemployment compensation taxes, local property and other taxes, and state taxes are all a part of the package of state and local costs as an employer sees them.

TECHNICAL NOTES

Property Taxes: The paper used for Table 3, "The Incidence of Maryland Taxes," was published in Maryland Tax Policy, Volume 4 of Maryland Policy Studies published by the Bureau of Governmental Research, University of Maryland (College Park, MD 20742). The author is Robert Schwab (U. of Maryland). The study methodology, which is the standard one, can provide misleading impressions in some situations. For example, over a lifetime the property tax may seem more burdensome to someone in their 30s with children and a large mortgage than someone retired with neither children nor mortgage. A special problem arises, particularly in central cities, through a combination of inflation and assessment practices. New and/or higher priced housing assessed values tend to lag price changes while inner city assessments reflect full market value of some properties and fail to reflect declining values of others. For example, in Philadelphia, one study (Philadelphia Inquirer, 2/18) found that assessed values were 39% of home values for houses with market value under $25,000, 21.3% for houses worth $75,000-100,000, and 20.8% for houses worth more than $200,000.

Certain forms of state tax relief, particularly circuit breakers and credits or deductions for property taxes paid, make local taxes seem cheaper to local officials because the state pays part of any increase. [They don't make property taxes look cheaper to the Census Bureau, so its statistics overstate property tax burdens where these relief programs are used.] The effect in encouraging higher taxes has been of concern to some state officials, particularly in Wisconsin where there is a widely accepted objective of holding down state and local taxes in relation to personal income. These forms of tax relief may also conflict with school equalization objectives by encouraging more affluent districts to increase spending. See Michael Addonizio (Indiana U.), "School Aid And Property Tax Relief: Some Evidence Of Conflicting Incentives," Journal of Education Finance (Summer 1990). The state relief programs are detailed in the Advisory Commission on Intergovernmental Relations (Washington, DC 20575) study Significant Features Of Fiscal Federalism, Volume 1.

The study on property tax limits appears in the National Tax Journal (June, 1991). The authors, Anne Preston and Casey Ichniowski, are on the faculty of the State University of New York at Stony Brook. The data on property tax assessments come from the Massachusetts Taxpayers Foundation, Public Sector Consultants (Lansing, MI), and the Wisconsin Taxpayers Alliance. The comparisons of property tax burden change were made by the Tax Foundation (Tax Features, May/June) 470 L'Enfant Plaza, SW, Washington, DC 20024. The study of assessments is Property Tax Assessment In Indiana, Indiana Fiscal Policy Institute (251 N. Illinois St., Indianapolis, IN 46204).

State And Local Fiscal Relations: The ACIR study is summarized by Robert Rafuse (ACIR) in Maryland Tax Policy cited above. The counties used in the article are the mountain county of Allegany (poor rural), Baltimore (central city), Calvert County (industrial enclave), and the Washington, DC suburb of Montgomery County (affluent suburb).

Miscellany: The electronic fund transfer survey appears in the Federation of Tax Administrators' Tax Administrators News (July). The exports study by Cletus Coughlin and Thomas Mandelbaum appears in the Federal Reserve Bank of St. Louis Review (July/August). ACIR's study is Changing Attitudes On Government And Taxes.

Most of the items in the discussion of federal grants come from Federal Funds Information For States (400 North Capitol St., NW, Washington, DC 20001). FFIS was established by the National Conference of State Legislatures and the National Governors' Association to improve state sophistication in dealing with federal grant issues, particularly complex grant formulas. It has had something to do with gradual changes since the early 1980s that have reduced the last minute surprises associated with grant allocations and other federal decisions.

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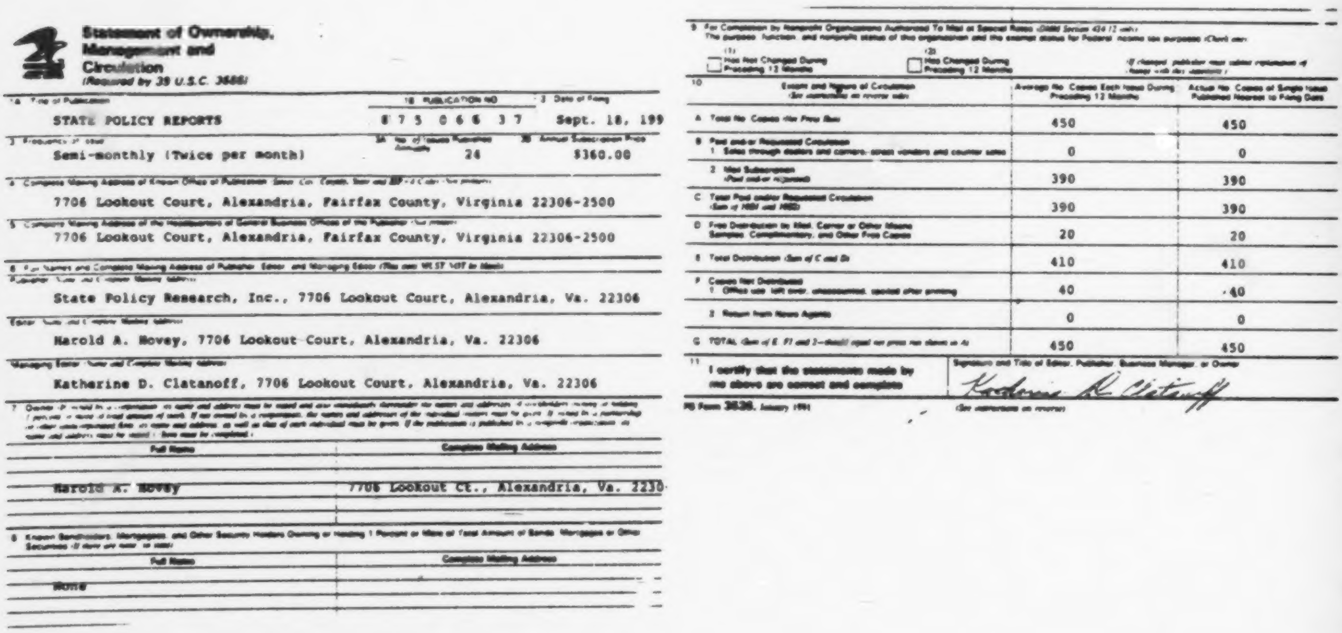

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VOLUME 9 ISSUE 20

State budgets are based on the assumption that the nation's economic recovery started this summer. No one told consumers and other economic decisionmakers. Unless a turnaround appears soon, the next 12 months in state finances will resemble the last 12.

- o Deteriorating State Fiscal Conditions p. 2

This year (FY 1992) only a third of the state budgets contemplate more revenue than spending. Only a third of the states expect to end the year with balances of 2.5% or more of revenues. So if all plans are realized, most states will be in bad shape. Otherwise, they'll be in worst shape.

- o This Year's Financial Outlook p. 8

State tax increases will lift state revenues about 5%. About 30 states raised some tax, but the big increases were concentrated in a few states. There was no particular favorite tax to raise.

- o Tax Actions And Trends p. 12

State budgets for FY 1992, despite the many tax increases, provide only enough spending growth to match inflation. Medicaid and corrections grew much faster, starving other programs.

- o Spending Trends And Outlook p. 15

State employment grew through last October, though the pace has slowed since. There are major differences among states in the number of employees relative to population and in compensation.

- o State And Local Employment p. 20

Technical notes provide comments on revenue estimates and amounts reported as tax increases. A summary table shows FY 1991 spending increases for all states for six spending categories.

- o Technical Notes p. 23

October 1991 (Second Of Two October Issues)

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DETERIORATING STATE FISCAL CONDITIONS

Introduction: State finances aren't in good shape. Much of this issue is devoted to what state fiscal officials reported to the National Conference of State Legislatures (NCSL) and to the National Association of State Budget Officers (NASBO). That information is valuable in comparing states, examining growth of spending for individual programs, reviewing tax changes, and other purposes. It is less than perfect for predicting exactly what the states will be doing this fiscal year. Sluggish tax collections, the threat of federal disallowance of some Medicaid matching funds, and escalating costs for social programs all suggest that there will be revisions in the state budgets reported in the two surveys.

There are lots of 50-state tables in this issue to give readers a feel for the fiscal situation of each state. Officials of individual states find this useful in determining where they stand relative to other states. Those readers concerned with tax policy like to speculate on where the chances of tax increases are greatest. Those interested in spending like to know the fiscal environment in which they will be pressing their cases.

Things Are Worse Than They Seem: The NASBO and NCSL surveys are imperfect indicators of state financial condition. The reason is simple. They reflect the premises of the state budgets as they were enacted, generally in June. For most states, they don't reflect the bad news that has occurred since June.

First, revenues in May and June were worse than anticipated in many states. This isn't surprising. Even the after-the-fact record keepers in the U.S. Department of Commerce assessed economic conditions incorrectly. They first issued a report showing there was economic growth in the second quarter. Then they revised the finding to show slower real GNP growth. Then they revised the finding again to show economic decline. These revisions paralleled reassessments of state revenues as estimates were replaced by data on actual collections. Lower-than-expected revenue produced lower-than-expected balances going into FY 1992 which, other things being equal, meant lower-than-expected balances at year end.

Second, revenues in July, August, and September have been lower than estimates in many, though not all states. Following the consensus estimates of economists in the spring, state officials predicted more growth than seems to have occurred.

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Third, many states are counting on federal matching money in Medicaid based on bootstrap financing arrangements that may be disallowed by federal action midway through the fiscal year.

Fourth, spending appears to be outrunning expectations in some social service and health programs. The problem is particularly acute in AFDC and general assistance caseloads and thus in Medicaid caseloads. Officials of some states appear to have underestimated caseloads, underestimated cost-per-case, or overestimated the impact of their cost-reducing strategies -- sometimes all three.

Finally, some state budgets reported in the two surveys weren't realistic when they were enacted. The situation is so serious that NCSL's report warns of it.

Signs Of The Times: Employment changes provide the best single indicator of what is happening in individual state economies. Table 1 reflects the situation in the larger states. It shows job loss in the last year as a percentage as well as the numbers of jobs involved and, in the final column, provides the unemployment rate this September.

Table 1: Change In Employment In Major States
September 1990 To September 1991

State	Percent Change	Job Change	Unemp. Rate
Michigan	-4.0%	-172,000	9.2%
Massachusetts	-3.6	-107,000	8.9
New York	-2.7	-223,000	6.8
New Jersey	-1.6	-61,000	6.0
Florida	-1.2	-70,000	8.0
Ohio	-1.0	-51,000	5.7
United States	**-0.5**	**-626,000**	**6.4**
Illinois	-0.4	-24,000	6.6
Pennsylvania	-0.3	-19,000	6.3
Texas	0.2	13,000	6.4
California	0.6	85,000	7.5
North Carolina	1.7	56,000	5.3

These numbers have dramatic impacts on state finances even by back-of-the-envelope calculations. If average pay of job losers was $15,000, Michigan's job loss in one year translates into lost income of about $2.58 billion. With state and local taxes taking about 11% of personal income, that means lost revenues of nearly $300 million.

Table 1 also shows major differences among the states. Reasonably current data for 50 states appear in the Index of State Economic Momentum (Issue 18). The Index shows that states in the West are doing somewhat better than the national average while East Coast states are doing worse. That geographic pattern is reflected in state finances.

How The Bottom Fell Out: The unanticipated recession was, far and away, the largest single contributing factor to state fiscal problems this year.

The conclusion is significant because to the extent recession is the problem, recovery is the solution, not necessarily permanent tax increases or spending cuts. If structural defects in state budgets are the problem, then recession merely worsens an already difficult fiscal situation. The worst case is to have both a recognizable structural deficit and problems clearly associated with recession. This was the California case, with a portion of the tax increase designed to be a temporary response to the economic downturn.

The recession's impact fell primarily on revenues, though there was some effect on general fund spending for welfare and Medicaid. The NASBO report provides data on original and current estimates for three major taxes in FY 1991: sales, personal income, and corporate income. Corporate receipts, which are about a fourth of each of the other two taxes, were 13% below estimates. Sales tax revenue shortfalls in relation to original estimates are shown on Table 2. States listed without values don't have sales taxes.

Table 2: Shortfalls in FY 1991 State Sales Tax Revenues
As Percentage of Original Estimate

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	-17.1%	17	South Carolina	-4.2%	34	Hawaii	1.3%
2	New Jersey	-13.0	18	Massachusetts	-3.7	35	Arkansas	1.5
3	Maryland	-9.4	19	Mississippi	-3.27	36	Utah	2.0
4	Rhode Island	-9.4	20	Arizona	-3.17	37	Colorado	2.1
5	Virginia	-8.4	21	Nebraska	-2.7	38	Nevada	2.5
6	Connecticut	-7.8	22	Georgia	-2.5	39	Wyoming	2.7
7	Michigan	-7.8	23	Vermont	-2.3	40	Louisiana	2.8
8	California	-7.4	24	Oklahoma	-1.6	41	South Dakota	2.9
9	Florida	-7.3	25	Minnesota	-1.0	42	North Dakota	3.1
10	North Carolina	-6.5	26	Alabama	-1.0	43	West Virginia	7.0
11	Indiana	-6.1	27	Idaho	-0.9	44	Washington	10.9
12	Pennsylvania	-5.8	28	Kentucky	-0.6	45	New Mexico	11.8
13	Ohio	-4.8	29	Wisconsin	0.0		Alaska	
	United States	-4.6	30	Texas	0.00		Delaware	
14	Illinois	-4.4	31	Kansas	0.1		Montana	
15	Missouri	-4.3	32	Maine	0.4		New Hampshire	
16	Tennessee	-4.2	33	Iowa	1.1		Oregon	

The national average is a shortfall of 4.6% -- a devastating impact in the context of already enacted state budgets.

Deviations among the states are significant. Differences between individual states and the national average come from such factors as the differing times when original estimates were made, differing conservatism in revenue estimating, and unpredicted deviations between state and national economic performance. Apparently there was a tendency for revenue estimators to assume that their states' economies would perform like the national average. As a result, the top listed states in Table 2 are East Coast states that felt recession most severely. States in the right hand column have been outperforming the national economy.

Table 3 provides the same information for personal income taxes as Table 2 provides for sales taxes.

Table 3: Shortfalls in FY 1991 State Personal Income Tax Revenues
As a Percentage of Original Estimate

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	-21.9%	17	Kentucky	-3.6%	34	Arkansas	2.3%
2	Virginia	-12.6	18	Massachusetts	-3.6	35	Oklahoma	2.4
3	California	-9.9	19	Ohio	-3.5	36	Montana	2.7
4	North Carolina	-8.8	20	Colorado	-2.5	37	Wisconsin	4.4
5	New Mexico	-8.8	21	Mississippi	-2.5	38	Hawaii	7.3
6	South Carolina	-8.3	22	Minnesota	-2.3	39	Idaho	8.0
7	North Dakota	-8.1	23	Vermont	-2.3	40	New Jersey	8.4
8	Delaware	-7.6	24	Maine	-1.6	41	West Virginia	9.3
9	Rhode Island	-6.8	25	Kansas	-1.5	42	Utah	11.3
10	New York	-6.7	26	Alabama	-1.2		Alaska	
11	Maryland	-6.6	27	Indiana	-0.9		Florida	
12	Michigan	-5.6	28	Iowa	-0.5		Nevada	
13	Georgia	-5.2	29	Arizona	-0.1		New Hampshire	
14	Tennessee	-4.9	30	Illinois	0.1		South Dakota	
	United States	-4.6	31	Oregon	0.6		Texas	
15	Missouri	-4.4	32	Nebraska	1.0		Washington	
16	Pennsylvania	-4.0	33	Louisiana	1.5		Wyoming	

Revenue Estimating Accuracy: These tables suggest state revenue estimators predicted revenue badly, with an average error of 4.6% nationally for both taxes. Basing a budget on the original estimates and then undertaking a mid-course correction to maintain balance would have required across-the-board spending cuts of 4.6%. That is about what happened in a few states.

In most states, the impact on spending was less severe. Some of the original estimates were revised downward before the FY 1991 budgets were enacted. Also some of the estimates of final outcome were not made until too late to adjust spending, so part of the shortfalls cut into balances rather than resulting in lower spending.

Nonetheless, the large errors documented in Tables 2 and 3 have caused great consternation among some state elected officials. As a result, some states are reassessing their revenue estimating procedures to determine what went wrong and what can be done better in the future. More such assessment may occur as these two tables circulate in the states. The underlying NASBO numbers, as presented in its report, don't leap out at the reader with particular conclusions. Calculating percentages and ranking states, as **Reports** has done, leads to some obvious questions such as why the estimating errors were so large and, particularly, why they differed so much among states in comparable circumstances.

It is plausible that state officials could make errors of this magnitude by using revenue estimating techniques that will, on reexamination, be continued with little change because they are the best available. The gross underlying error was assuming that national economic growth would continue at a 2-4% clip. It didn't. The actual number, when finally decided upon by the keepers of the national income accounts, will be around 0%. The difference accounts, more or less, for a 2-4% error.

In the personal income tax, the error is magnified by refunds of money already counted. For example, someone who lost a job in the fall of 1990 would have paid full withholding during all of a state's FY 1990 but FY 1991 revenue would suffer both: (1) from the loss of withholding from the job loss and (2) from refunds claimed in early 1991 based on overwithholding in 1990. Sales tax losses would also be more than the decline in economic activity because the decline disproportionately affected sales of big ticket items like furniture and cars. So the results shown for most states on Tables 3 and 4 aren't totally out of line. A discussion of states deviating grossly from the national average appears in the Technical Appendix.

Planning For Recession: It is unlikely that states will avoid the fiscal shocks of recession years like 1991 by improving revenue estimating procedures. The big mistake of state estimators was following what was then the consensus of national economic forecasters (or their own econometric consulting service which itself mirrored the consensus). The error could have been avoided if state estimators had independently forecast recession. But such totally independent forecasts aren't likely to develop. First, state revenue estimators are not, and are not believed to be, better national forecasters than the national forecasters and therefore would have a credibility problem. Second, state estimators aren't likely to stray far from the national consensus for the same reasons corporate economists don't. Third, and perhaps most important, elected officials aren't going to find it easy to deny pay raises and school aid increases based on economic assumptions sharply different from those prevailing at the time. When a state estimator forecasts recession when others making forecasts don't, this is exactly what state officials are asked to do.

This means the cure for the budget revisions of 1991 lies elsewhere. There are several successful strategies. The first is conservatism in the estimates. This is difficult to measure, but is particularly found in states with volatile commodities prices affecting their income or a spurt of income growth that might not continue. Examples where revenues were above estimates in FY 1991 are Alaska, the Dakotas, Utah, and West Virginia. A second approach is to appropriate less than a full revenue estimate indicates, which is done by automatic procedures in Oklahoma and South Carolina.

A third approach is to have a substantial portion of the budget in items that can be deferred if revenue estimates are wrong. Examples are capital outlays to be paid out of general revenue, salary increases contingent on resources being available, and the like. This is how Virginia adjusted without tax increases. Arkansas makes the whole budget dependent on revenues available by appropriating in priority classes (tiers). Alabama's practice is to prorate education appropriations depending on fund availability. The fourth approach is to have money in the bank in the form of balances and rainy day funds. This is how Indiana avoided excruciating budget cuts or major tax increases.

Developments This Fall: The developments in many states in the first three months of the fiscal year suggest serious difficulties if there is no national economic turnaround soon. California's problems are the most striking. In late October, the governor began talking of a shortfall of $2 billion or so. The Commission on State Finance revised its estimates of spending and revenues to indicate a projected FY 1992 shortfall of about that amount. New York's mid-year budget review also indicated a shortfall. In both cases, the cause is a combination of revenues dropping below estimates and spending, particularly for Medicaid and social services, running above estimates.

Problems in the Southeast produced such large shortfalls that most affected states have already taken major action to reduce spending. Georgia and Maryland held special legislative sessions for the purpose. Florida's governor decided he could take about the same action without legislative approval. The state supreme court has held otherwise, making a session necessary. Alabama and Mississippi budgets are in proration, a proportionate reduction of expenditures to match the reduction in revenue estimates.

Judging what administrative cutbacks to make in state budgets is difficult. Recent economic statistics have been ambiguous about whether recovery is on the way. By failing to act quickly, state officials risk finding their budgets widely out of balance if national economic recovery doesn't occur. But when recovery comes, it might well be quite rapid, such as GNP growth at a 6% annual rate rather than the 3% of the late 1980s. So acting quickly could leave state officials administering major cuts in already austere budgets at the same time that revenues are rolling in above expected levels.

THIS YEAR'S FINANCIAL OUTLOOK

Introduction: The FY 1992 budgets indicate problems in three important dimensions of financial health. Balances going into the year are low. Spending during the year will exceed revenue during the year in nearly half the states. Planned balances at the end of FY 1992 are low by historical standards and by most standards of prudent reserves.

Operating Surplus Or Deficit: A simple, but relevant, way of looking at state finances is whether money taken in during the year is expected to be enough to pay that year's bills.

State definitions of deficit and surplus are comparable to those individuals use in keeping checkbooks. If there is a positive balance at the end of the year, the budget is considered balanced whether there was a penny in the bank at the beginning of the year and at the end or there was a massive balance at the beginning that shrank to nothing at the end. In corporate and federal accounting, spending more than revenues would show a deficit.

Putting state budgets on a private sector basis provides some revealing statistics. Table 4 was developed from statistics in the NASBO report. The numbers shown reflect the excess (deficit) of revenues in FY 1992, the new budget year, as a percentage of spending.

Table 4: FY 1992 State Operating Surplus/Deficit
As a Percentage of Expenditures

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	California	6.7%	17	New York	0.1%	34	South Dakota	-0.9%
2	Hawaii	4.4	18	Maryland	0.0	35	Indiana	-1.1
3	Pennsylvania	3.3	19	Alabama	0.0	36	Ohio	-1.1
4	Alaska	2.1	20	Arkansas	0.0	37	Nevada	-1.4
5	New Jersey	1.6	21	Colorado	0.0	38	Utah	-1.6
6	Maine	1.5	22	Connecticut	0.0	39	Oregon	-2.2
7	Vermont	1.4	23	Michigan	0.0	40	Kentucky	-2.9
8	Oklahoma	1.1	24	North Carolina	0.0	41	Washington	-3.1
9	New Mexico	1.0	25	Rhode Island	0.0	42	West Virginia	-3.3
10	New Hampshire	0.9	26	Tennessee	0.0	43	Kansas	-3.5
11	Illinois	0.8	27	Iowa	-0.0	44	Idaho	-4.5
12	Florida	0.8	28	Mississippi	-0.0	45	North Dakota	-6.5
13	South Carolina	0.6	29	Delaware	-0.2	46	Texas	-7.1
	United States	**0.4**	30	Georgia	-0.3	47	Nebraska	-7.3
14	Arizona	0.4	31	Massachusetts	-0.5	48	Montana	-8.7
15	Virginia	0.4	32	Wisconsin	-0.6	49	Louisiana	-8.8
16	Missouri	0.2	33	Minnesota	-0.8	50	Wyoming	-9.8

Just over a third of the states are operating in the black by covering current spending with current revenues, using any money left over to rebuild reserves. Another third are spending at least 1% more than their revenues. How safe this is depends on how large reserves are.

Assessing Projected Operating Results: The situations of the states shown on Table 4 fall into several distinct categories as shown in Table 5.

Table 5: FY 1992 State Fiscal Strategies

Fiscal Situation/Strategy	Operating Surplus	Ending Balance	Number of States
Rebuilding Balances	Over 1%	Over 1%	8
Normal Operation	0-1%	State's Own Target (0-7%)	18
Using Large Balances	Negative, In Deficit	Over 5%	8
Deficit Operation/ Low Balances	Negative, In Deficit	Under 5%	16

Eight states, the top-ranked states on Table 5, are planning to rebuild their reserves with their FY 1992 budgets. Mostly they are states that enacted large tax increases and are using the money to pay expenses in FY 1992 and recoup losses in their financial position from prior years. California, Pennsylvania, Maine, and Vermont are the examples. The others are special cases of reasonable prosperity (Alaska and Hawaii) or tax increases last year (Oklahoma and New Jersey).

If all were going smoothly in a state's finances, the number shown on Table 4 would be slightly above zero. Revenues would cover spending and, to keep balances at a steady 3-5% of expenditures, states would add about 0.2-0.4% to balances. This addition to balances would keep them a constant percentage of growing spending. Eighteen states more or less fit this pattern with operating surpluses ranging between zero and 1%.

Another pattern consistent with strong state financial management is to spend more than current revenues because balances at the beginning of the year were above the state's targets. Spending part of that money will produce a negative number on Table 4, but still leave the state in a strong position. Eight states show negative numbers on Table 4 but project ending balances at 5% of spending or more. They (and their ending balances) are Delaware (9%), Indiana (6%), Minnesota (7%), Nebraska (11%), Nevada (5%), North Dakota (15%), Oregon (12%), and Washington (7%).

The hazard is that the resulting spending pattern will be greater than revenues in FY 1993 can sustain. The hedge against that hazard is using some of the spending for one-time items such as capital outlays, one-time extra contributions to pension systems, and accelerating payments of employees, vendors, and local governments.

States With Apparent Fiscal Problems: The categories above leave a whopping 16 states, a third of the nation, with fiscal problems in their enacted budgets shown by the numbers used when they were enacted. For the reasons stated at the beginning of this article, their problems now seem worse than when they enacted the budgets summarized by the tables in this issue.

Out of this group there are some special cases such as Wyoming's ample resources in special funds and Idaho's and Utah's prosperous economies. The others are indicative of built-in fiscal problems for states in FY 1993 even if the economy recovers somewhat, as is assumed in most state budgets.

Louisiana and Mississippi avoided tax increases in their election year. In Mississippi, the post-election period will see a resumption of education finance discussions. Both a sales and an income tax increase have passed one House or the other, but the governor has held out for a lottery and fee increases. The state's aspirations for education, many enacted into law, would require substantial new revenue. Louisiana has a tradition of running down reserves in an election year, followed by a post-election tax increase. Finances were not much discussed in the campaign but will soon become a major issue.

There is considerable sentiment for tax increases in Montana and Wisconsin. Legislatures in these states (and also Minnesota) passed tax increases that were vetoed by governors. In Kansas, a majority of legislators wanted one tax increase and the governor wanted a different and larger one. In these states, and more, tax increases are likely to be on the agenda next year.

This leaves other states, each with relatively unique problems and circumstances. In Texas, the major risk is a reopening of the school finance cases plus cost overruns in Medicaid and social services. In Oregon, the problem is adjusting to a limit on local property taxes that, sooner or later, will require a large infusion of state resources. In Georgia, the question is whether the spending cuts already made after FY 1992 began will be enough. In Delaware, Indiana, Iowa, Kentucky, Ohio, South Dakota, and West Virginia, the question is how well the revenue and spending estimates will hold and whether decisionmakers will accept relatively austere spending levels in FY 1993.

Projected State Balances: One common indicator of state fiscal condition is the balances held as surpluses and rainy day funds.

From time to time, a figure of 5% of a year's spending is discussed as a target for each state, a prudent level of reserves. There is no empirical base for such a nationwide target. Logically balances for states, like cash reserves for households, should differ depending upon the risks to which each is subject and the other hedges against uncertainty present in individual financial practices.

For example, states like Arkansas and Alabama with strong traditions and laws for adjusting spending downward to cover revenue surprises shouldn't need the same balances as states where such traditions and laws are weaker. States with diversified economies, like Illinois and California, shouldn't need balances as large as those dependent on a few industries or firms like Oklahoma, the Dakotas, and Washington. Those dependent on volatile graduated personal income taxes and corporate income taxes, like Minnesota and Wisconsin, should have larger balances than those dependent on sales taxes and corporate franchise taxes like Texas and Washington. States with reserves tucked away in various special funds, like Alaska and Wyoming, need less cushion than those with accounts payable lurking in various accounts, like New York.

Some states have their own balance targets established by law or practice. For example, the target in Arkansas is 0% while the California target is 3%.

Despite these differences, the comparison of balances shown in Table 6 can be useful in considering how states relate to each other.

Table 6: Projected Total Balances as a Percentage of Expenditures, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Vermont	-7.3%	18	Tennessee	0.5%	34	Michigan	2.8%
2	New Hampshire	-3.9	19	Louisiana	0.7	35	Kansas	2.9
3	Texas	-3.7	20	Missouri	0.9	36	Colorado	3.3
4	Alabama	0.0	21	West Virginia	1.1	37	California	3.6
5	Arkansas	0.0	22	Wisconsin	1.1	38	Wyoming	4.1
6	Connecticut	0.0	23	Florida	1.2	39	New Mexico	4.6
7	Georgia	0.0	24	Ohio	1.2	40	South Dakota	4.8
8	Iowa	0.0	25	Arizona	1.5	41	Nevada	5.1
9	Massachusetts	0.0	26	Illinois	1.6	42	Indiana	6.4
10	North Carolina	0.0	27	New Jersey	1.6	43	Minnesota	6.9
11	Pennsylvania	0.0	28	Kentucky	1.7	44	Washington	6.9
12	Utah	0.0	29	Maine	1.8	45	Delaware	8.8
13	New York	0.1		**United States**	1.9	46	Nebraska	10.8
14	Rhode Island	0.1	30	Alaska	2.1	47	Oregon	11.6
15	Mississippi	0.2	31	Montana	2.1	48	Oklahoma	13.1
16	Maryland	0.3	32	Idaho	2.4	49	North Dakota	15.3
17	Virginia	0.4	33	South Carolina	2.4	50	Hawaii	17.1

Negative numbers, as shown for three states, are bad news. The Texas number reflects a single year of a biennium, with the state's balanced budget requirement applicable to the biennium. Only ten states meet a 5% target. The balances are dramatically lower than in the late 1980s. From the end of FY 1984 through the end of FY 1990, balances were in a range from 3.1% to 5.2% of spending. They dropped to an estimated 1.5% at the end of FY 1991 and are predicted to rise to only 1.9% as result of the new budgets.

The balances are truly slim. For example, if economic growth in FY 1992 turns out to be at a 1.5% annual rate rather than 3% assumed in many budgets, the balances would (without tax increases or spending cuts) drop to about zero. If Medicaid and corrections spending overruns follow past patterns, supplemental spending bills could chop about 1% out of the planned 1.9% balances.

TAX ACTIONS AND TRENDS

Large Tax Increases In 1991: The tax increases in 1991 were massive by the standards of the recent past. Total increases reported in the surveys were about 5-6% of revenue, depending on who is doing the counting. This is the largest percentage increase since 1971. The amount of the increase is the greatest in history. Table 7 shows the increases in recent years as shown by the two surveys and the percentage shown by the NCSL survey. The reasons for the discrepancies between the NCSL and NASBO reports are discussed in the Technical Appendix.

Table 7: Tax Increases Enacted In 1991 for FY 1992 ($ billion)

Fiscal Year Affected	Percent Of Revenue	Amount NCSL	Amount NASBO
1992	5.4%	$16.2	$15.0
1991	3.4	9.5	10.3
1990	1.3	3.5	4.9
1989	0.2	0.6	0.8
1988	1.9	4.5	6.0
1987	0.5	1.1	0.6
1986	-0.6	-1.3	-1.1

The returns may not all be in. In the last major recession, some states adopted major tax increases in special sessions after the November elections. Colorado recently held a special session on funding the school aid formula, but didn't reach agreement on any tax measures. There are discussion of special sessions in Maryland and Tennessee and probably other states.

Tax Increases By State: There were tax increases in about 30 states. Table 8 shows the percentage increases in taxes as reported by NASBO, expressed by **Reports** calculation as a percentage of FY 1991 revenue. The table is designed to answer the question of which states raised taxes how much and, thus, which tax increases were the largest relative to other states. The table includes only those states where some change in tax levels occurred.

Table 8: Tax Increases As a Percent of Revenue, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Pennsylvania	21.5%	13	Montana	5.4%	24	New Mexico	1.0%
2	Nevada	18.0	14	Tennessee	5.2	25	South Carolina	0.8
3	Connecticut	15.9		**United States**	**5.0**	26	Washington	0.8
4	Arkansas	14.4	15	Minnesota	5.0	27	Alabama	0.6
5	Vermont	13.0	16	Nebraska	3.8	28	Hawaii	0.6
6	California	12.3	17	Oregon	3.5	29	Wisconsin	0.6
7	Maine	11.9	18	New York	2.7	30	Iowa	0.6
8	Missouri	8.1	19	Florida	2.4	31	Arizona	0.2
9	North Carolina	7.9	20	Maryland	2.3	32	Michigan	-0.1
10	Delaware	7.7	21	Idaho	1.6	33	New Jersey	-0.2
11	Texas	6.7	22	Ohio	1.3	34	Louisiana	-0.3
12	Rhode Island	5.6	23	Illinois	1.2	35	Massachusetts	-1.5

These tax increases differ from many of those in the late 1980s in one respect: Most didn't buy anything of direct interest to voters. The typical tax increases were primarily oriented to purposes called "balancing the budget," "avoiding spending cuts," and "keeping the doors of state government open." There were some exceptions. The Arkansas and Missouri increases, for example, were associated with increased education spending.

Local Taxes: Neither of the surveys attempts to assess the impact of state decisions on local tax rates. Some of the impacts were substantial. In some cases, state legislatures approved new taxing authority for local government. The approval of a local option sales tax for Philadelphia and a package of local taxes for New York City are examples. In other cases, state decisions to cut local aid forced local decisions on cutting spending or raising taxes. Some of these decisions were, no doubt, made in favor of increasing taxes. Examples are Massachusetts, New York, and Rhode Island. In other cases, the state action in rewriting the school aid formula forced local property tax increases. Examples are Kansas and Texas.

Which Taxes Were Increased? There was no particular favorite among taxes to increase. Table 9 shows the increases reported in the two surveys. For lack of any compelling reason to use one survey or the other, Table 9 includes both. Unintentionally, this has the effect of highlighting large differences among the two organizations in reporting (1) how much taxes were raised and (2) what taxes were raised. These differences are locally significant in some states, but don't affect the major conclusions about tax policy nationwide.

Table 9: State Taxes Increased In 1991 ($ million)

	Amount		Percent Of Total	
	NCSL	NASBO	NCSL	NASBO
Personal Income	$6,495	$5,430	39.9%	36.1%
Sales	5,062	3,850	31.2	26.5
Corporate Income	1,690	1,439	10.4	9.6
Tobacco	217	246	1.3	1.6
Alcoholic Beverage	220	204	1.4	1.4
Motor Fuels	716	629	4.4	4.2
All Other	1,817	3,232	11.2	21.5
TOTAL	$16,217	$15,029	100.0%	100.0%

Personal income taxes were relied upon more than others nationwide, but nearly all of the increase reflects the large increases in California, Connecticut, and Pennsylvania. The other significant developments were increases in a few states that were part of a package also involving sales (e.g., Maine, Missouri, and Vermont) or relatively minor adjustments involving special groups such as retirees, higher income taxpayers (New York), and real property tax deductions (Illinois).

California's $2.5 billion increase dominated the sales tax category. The other large increases were in Arkansas, Maine, Minnesota (a mandatory local option oxymoron), Missouri, Nevada, North Carolina, Pennsylvania, and Texas. Connecticut used some of its revenue from the new income tax to lower sales taxes.

Major corporate income changes were confined to a few states. The total of $1.4 billion of increases consists primarily of $552 million in California and $601 million in Pennsylvania. Smaller increases in Arkansas, Maine, Missouri and North Carolina reflect a corporate share of a total tax increase that primarily consisted of taxes on individuals.

Excise taxes didn't gain much attention. NASBO counts nine states that raised gasoline taxes. These per-gallon taxes tend to be increased over time as the purchasing power of their revenue declines with inflation and greater gas mileage of newer vehicles. Some states make this adjustment administratively. Others act in relatively large increments every three to five years. Uncertainty about the still-pending federal highway legislation renewal may have held down the number of gas tax increases.

Excises on tobacco products and alcoholic beverages weren't popular. This is consistent with the role they appear to have assumed in state revenue raising. They are often used to raise relatively small amounts of money in situations where elected officials want to be able to assure the electorate that they haven't raised general taxes or, as some put it, broad-based taxes. But when heavy lifting is required as was the case this year, they are less often tapped. Their revenue contribution is limited, their likely yield growth is negative, and politically they carry with them possible opposition to be piled on top of whatever opposition already exists to raising taxes.

There were only two increases of alcoholic beverage taxes. The North Carolina increase was part of a package that deliberately raised every tax. The California increase was supported by alcoholic beverage interests, who fear even larger increases by voter initiative. There were 13 states with some form of tobacco tax increase, with Pennsylvania's accounting for about half the revenue raised.

SPENDING TRENDS AND OUTLOOK

Introduction: State spending trends are simultaneously showing two developments that contrast with the pattern of much of the 1980s. One is slower overall growth in spending. The second is a larger percentage of spending increases being devoted to Medicaid and corrections spending. They are not necessarily growing faster in percentage terms, but past high percentage growth has made them a larger share of the budget. As a result, the continuing large increases take a larger and larger bite out of funds available for other programs.

Total Spending Growth: As estimated by the states responding to the NASBO survey, total state general fund spending will increase by 5% to a total of $302 billion. Constrained by mid-year cutbacks, the reported increase for FY 1991 is 4.5%. The comparable figures from the NCSL survey are 5.4% and 4.9%. These numbers are all close to the inflation rate that has prevailed for the last several years.

The growth rate is considerably below the late 1980s. In the five years of FY 1986 through FY 1990 state general fund spending grew by about 7.5%, which was nearly 3% above the inflation rate. With such a change in the fiscal environment, some beneficiaries of state spending had to lose increases they were accustomed to receiving. In the new fiscal environment, some trends of the 1980s were under substantial pressure. They include: (1) state employee and teacher wage increases exceeding inflation by a substantial margin, (2) growing percentages of school costs paid by state aid rather than property taxes or the federal government, and (3) large increases in Medicaid and corrections, often funded without tax increases.

Planned Spending Increases By State: Table 10 ranks the states based on the spending increases they reported in the NASBO survey.

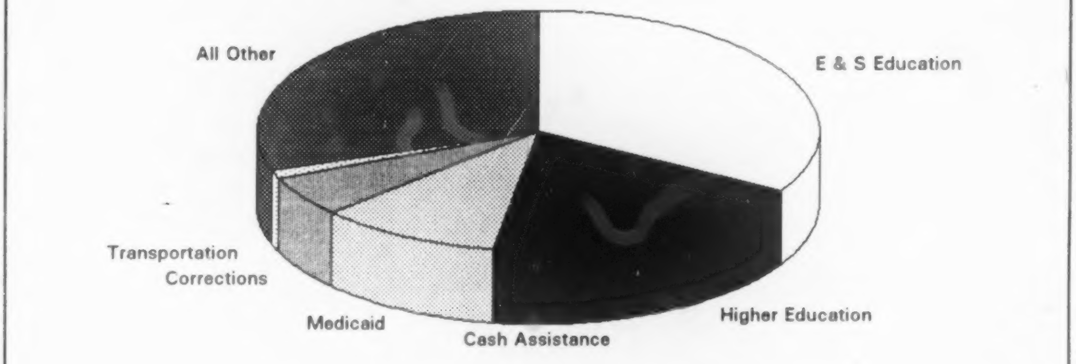
Table 10: Projected FY 1992 Spending Increases

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New Jersey	16.4%	17	Arkansas	4.9%	34	New Hampshire	2.3%
2	Montana	14.6	18	Ohio	4.9	35	Colorado	2.0
3	Oregon	13.8	19	Arizona	4.4	36	Maine	1.8
4	Pennsylvania	12.3	20	Maryland	4.2	37	Missouri	1.5
5	North Dakota	12.2	21	South Dakota	4.2	38	Kansas	1.5
6	Texas	12.1	22	Alaska	4.1	39	Georgia	1.3
7	Florida	11.1	23	Utah	4.0	40	Wyoming	1.0
8	Nebraska	10.9	24	Washington	3.8	41	Indiana	0.3
9	Kentucky	10.1	25	Vermont	3.6	42	Tennessee	0.2
10	Idaho	8.4	26	Delaware	3.3	43	Louisiana	0.1
11	West Virginia	7.6	27	New York	3.2	44	Michigan	-0.1
12	Nevada	7.2	28	Wisconsin	3.2	45	Virginia	-0.1
13	California	7.0	29	Oklahoma	3.0	46	South Carolina	-1.2
14	North Carolina	6.4	30	Mississippi	2.9	47	Connecticut	-1.5
15	New Mexico	6.1	31	Rhode Island	2.9	48	Hawaii	-2.1
16	Illinois	5.9	32	Alabama	2.4	49	Massachusetts	-3.0
	United States	5.0	33	Iowa	2.3	50	Minnesota	-6.0

The table suggests that the national average is no where near the typical (median) state, which has budgeted an expenditure increase of about 3.5%. Twenty-four states show increases of at least 1% but less than 5%. Most of the states with double digit increases are those that increased taxes. There are a few special situations (e.g., Montana and Oregon) that reflect misleading year-to-year comparisons because of a state decision to allocate spending to one year rather than another.

Seven states show actual cuts. Adjusting for inflation, these figures mean they are planning a 5% (Michigan and Virginia) to 11% cut in the real level of state activities. Past patterns suggest these forecasts may not be realized, at least not on an apples-to-apples basis. In part they are driven by shifts in financing responsibility by expecting local governments to accept lower state aid. In part, they represent sharp curtailment of capital projects traditionally funded through the general fund. But in part, they also reflect optimism about ability to control costs in programs like Medicaid.

Spending Growth By Program: As shown in the chart, education constitutes about half of state general fund spending.



The relative share of education is significantly threatened by the forces working on state budgets. With total spending growth in the 5-7% range and Medicaid and corrections growth in the 8-20% range, education must be squeezed to increases below 5-7%. This doesn't show in projected spending, for reasons discussed below, but it does appear in the FY 1991 increases reported in NASBO's special expenditure survey. Table 11 contrasts three indicators of program preferences in state budgets; (1) the NCSL fiscal survey's report on FY 1992 percentage increases, (2) the NASBO expenditure report on FY 1991 increases, and (3) the FY 1992 increases for Georgia reported to NCSL. Georgia was selected because it is an austere budget (no major tax increases) and reflects candid assessments of what the state is likely to spend.

Table 11: Three Views of Percentage Increases In State Budgets

Program	NCSL	NASBO	Georgia
Elementary And Secondary Education	8.9%	5.7%	1.2%
Higher Education	2.2	5.6	3.8
Cash Assistance/AFDC	1.2	6.7	10.6
Medicaid	21.8	20.9	20.0
Corrections	8.0	11.4	12.8
TOTAL GENERAL FUND	4.9	7.3	-1.0

Georgia's strategy is clear from the table. Given a tight budget, federal mandates, desires to avoid cutting existing health and cash assistance for the poor (which is not generous by national standards), the state's decisionmakers explicitly squeezed education in the FY 1992 budget. Within a much more generous total increase, that's also what the NASBO report indicates all states did in FY 1991.

The NCSL report reflects this pattern in double digit increases for Medicaid and corrections. However, it reflects a smaller increase in AFDC and a larger increase in elementary and secondary education than the other two. There are two major reasons why. First, the AFDC budgets reflect underestimates, given all anyone now knows about caseload changes. As NCSL's report politely puts it, the state budgeters are optimistic but, "their optimism may by misplaced. "Second, the education spending is an average that is heavily influenced by massive increases in large states that raised taxes such as California and New Jersey which both reported a 22% increase.

Examples Of State Strategies: While the budgeted increases for individual programs for FY 1992 may deviate considerably from what will actually be spent, the same problem shouldn't arise as seriously in the FY 1991 spending estimates. This spending was reported when the books were already being closed on the year, so there will be few changes in most states. Table A-1 in the Technical Notes shows the percentage change in spending for 50 states and five programs plus the total general fund. Table 12 (opposite page) is a selection of states to illustrate the current choices being made in state budgets.

Typical Spending Priorities: The typical state didn't increase taxes in 1990, so its total FY 1991 budget increase was the 5-8% that could be funded with current taxes. Of the states shown, Pennsylvania did more, but only at the expense of needing the large tax increase enacted this year. Education typically received increases that were lower than the overall spending increases and, in states that didn't raise taxes, at or below the inflation rate. Cash assistance increases were well below Medicaid increases, even though there is substantial overlapping of recipients in the two programs. There were two reasons for this. First, federal mandates added Medicaid recipients. Second, health care providers more often got reimbursement increases than welfare recipients got payment increases.

Education Cuts: The six states shown under "education cuts" on Table 12 illustrate the pressure that higher spending for welfare, Medicaid, and corrections put on education when state spending growth is low. Cash assistance grew by an average of over 10% in these states while Medicaid grew at over 20%. Corrections spending growth showed more variation. Total budget increases ranged from 6% in Tennessee to shrinkage in Massachusetts and Rhode Island. Three of the six states cut public school aid and five of the six reduced higher education spending.

Money To Spend: The last group of states shows the path to double digit increases for public schools. Washington did it by extraordinary economic growth while the other four states used tax increases. Their pattern of increases for welfare, Medicaid, and corrections wasn't greatly different from other states.

Table 12: Percentage Change In FY 1991 Spending, Selected States

State	El. & Sec. Education	Higher Education	Cash Assistance	Medicaid	Corrections	Total
National Pattern						
UNITED STATES	**5.7%**	**5.6%**	**6.7**	**20.9**	**11.4**	**7.3**
Arkansas	4.2	1.8	19.7	3.8	9.0	4.7
California	3.6	9.6	6.0	17.1	15.8	6.9
Illinois	2.3	3.7	5.5	13.4	13.3	8.0
Missouri	4.0	3.1	11.0	45.9	8.2	5.3
Ohio	5.7	3.4	10.4	20.3	14.2	8.0
Pennsylvania	5.9	6.3	10.1	48.7	18.9	10.2
Virginia	5.5	3.6	6.8	27.7	14.9	4.8
Education Cuts						
Connecticut	-7.0	7.2	15.4	30.6	30.5	3.9
Georgia	2.3	-0.2	18.1	40.2	-9.2	4.3
Massachusetts	-14.5	-9.6	6.4	12.2	6.4	-0.7
New York	1.0	-0.7	10.5	20.2	3.9	2.6
Rhode Island	-15.3	-9.0	21.9	16.1	13.2	-0.3
Tennessee	3.2	-2.5	19.0	23.3	3.7	6.0
Money To Spend						
Kentucky	18.6	13.4	15.5	27.0	17.8	16.3
Nebraska	79.3	14.5	7.4	12.4	32.7	24.3
Oklahoma	20.1	5.1	7.6	10.1	14.1	10.5
Texas	12.2	5.9	21.1	34.5	21.5	11.1
Washington	12.7	7.0	6.1	17.7	11.1	17.9

Education As The Swing Spending Category: This table is suggestive of the worst fears of those concerned with education. It would appear, at least in the FY 1991 budgets, that education was the swing category. Major increases were accepted by state budgeters in welfare, corrections, and Medicaid. If economic growth was slow and taxes weren't raised, education got what was left over. This often wasn't much by historical standards. If growth was fast or taxes were increased, essentially all the extra growth went for education.

For several years, state officials have been complaining that rapidly escalating Medicaid costs are sharply curtailing their ability to fund other programs, particularly education. Now enough time has passed so that data are available to see whether this is true. It seems to be.

STATE AND LOCAL EMPLOYMENT

Introduction: While the media reports are filled with announcements of layoffs in state and local government and shortages of state and local workers, state and local employment has been steadily growing.

Nationwide Patterns: Comprehensive statistics on public employment are kept by the Census Bureau which provides detail, but only with a lag in reporting. The latest information is from Public Employment: 1990, a report based on October 1990 payrolls that was issued recently. It shows steady increases in state and local employment as shown in Table 13 for total employment, full-time equivalent (FTE) employment, and employment as a percentage of population.

Table 13: State And Local Employment (000) In October Of Various Years

Year	Total	FTE	Percent Of Population
1990	15,263	13,080	5.26%
1989	14,765	12,723	5.13
1988	14,476	12,404	5.05
1987	14,121	12,101	5.02
1986	13,913	11,853	4.92

Corrections Leads Employment Growth: The attempts to cut state spending to meet revenue shortfalls have usually included some type of control over staffing such as hiring freezes and layoffs. However, their impact has often been limited by exceptions found necessary for operations with fixed staffing ratios. Examples are the number of prison guards per wing, the number of nurse/attendants per ward, the number of parolees per parole officers, and the number of clients caseworkers are asked to handle. Within elementary and secondary education, local preferences and state mandates have been reducing the number of students handled per teacher. These two phenomena have tended to raise the ratio of population to employment. In fields like corrections, there have been increasing workloads. In fields like education, there has been richer staffing. The results are shown in the one-year increase in employment shown on Table 14.

During the year covered by Table 14, every major function except utilities had employment growth in excess of the population growth, which was about 1%. The hospital growth was artificially depressed by two factors: (1) the shift of mental health patients from state hospitals to community programs and (2) the shift of public hospitals to private or not-for-profit status.

Table 14: Percentage Increase in State And Local Employment, 1989-1990

Function	Percent Change	Workers (000)
Corrections	7.3%	513
Public Welfare	5.6	489
Health	5.0	356
Elementary And Secondary Education	3.7	5,572
All State And Local Activities	3.4	15,263
Higher Education	3.4	2,278
Fire Protection	3.2	327
Financial Administration	2.9	349
Police protection	2.6	754
Highways	2.2	569
Hospitals	1.9	1,145
Utilities (e.g., electric and water)	0.9	450

Employment Levels By State: Table 15 shows the October 1990 employment of each state in relation to its population.

Table 15: State and Local Government Employment
As a Percent of Population, October 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Pennsylvania	4.11%	18	West Virginia	5.14%	34	Colorado	5.60%
2	New Hampshire	4.46	19	Indiana	5.15	35	South Carolina	5.60
3	Rhode Island	4.70	20	Maryland	5.19	36	Alabama	5.63
4	California	4.76	21	Tennessee	5.21	37	Delaware	5.64
5	Connecticut	4.77	22	Maine	5.24	38	Hawaii	5.66
6	Missouri	4.79	23	Washington	5.24	39	Louisiana	5.69
7	Massachusetts	4.80		**United States**	5.26	40	Oklahoma	5.78
8	Ohio	4.83	24	North Carolina	5.29	41	Georgia	5.90
9	Illinois	4.91	25	Minnesota	5.34	42	Mississippi	5.90
10	Michigan	4.94	26	Oregon	5.37	43	Iowa	5.93
11	Arizona	5.07	27	New Jersey	5.38	44	Nebraska	6.16
12	Florida	5.07	28	South Dakota	5.40	45	Kansas	6.21
13	Nevada	5.07	29	Virginia	5.45	46	New York	6.40
14	Utah	5.10	30	Vermont	5.46	47	New Mexico	6.41
15	Wisconsin	5.11	31	Texas	5.47	48	Montana	6.45
16	Arkansas	5.12	32	North Dakota	5.48	49	Wyoming	7.78
17	Kentucky	5.14	33	Idaho	5.58	50	Alaska	7.86

The only meaningful comparison among states combines state and local employment. Some states (e.g., California and New York) have unusually low state totals but higher local totals because welfare workers are local employees there but state employees elsewhere. Teachers in Hawaii and local road workers in Delaware are state employees, giving those states higher state totals but lower local totals.

There are many reasons for the differences on Table 15. States that are heavy spenders, like Alaska and New York, have larger-than-average numbers of public employees. Another factor is the distribution of functions between private and public sectors. Georgia, Mississippi, and Wyoming have extraordinary numbers of hospital employees while New Hampshire and Rhode Island have almost none. A third of the states have liquor store employees, the rest don't. Nebraska supplies electric power through the public sector, an unusual arrangement. Most water is supplied by government employees, but private water utilities are common in New England.

Employee Compensation: According to the Census data, state and local employees didn't do particularly well in raising their compensation between October of 1989 and 1990. The average monthly earnings increased by 4.4%, which is about the rate of inflation. Average earnings are shown in Table 16. The rankings on the table bear some resemblance to other measures such as average pay in the private sector and per capita income. However, the mix of employees will also affect the averages.

Table 16: Average Monthly Earnings of State and Local Employees, October 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$3,518		**United States**	$2,395	34	Missouri	$2,026
2	California	$3,104	18	Hawaii	$2,368	35	Kansas	$2,011
3	Connecticut	$2,915	19	Delaware	$2,342	36	Texas	$2,008
4	New York	$2,846	20	Oregon	$2,316	37	Montana	$1,995
5	New Jersey	$2,742	21	Iowa	$2,305	38	Kentucky	$1,938
6	Maryland	$2,717	22	Ohio	$2,303	39	Tennessee	$1,935
7	Michigan	$2,708	23	New Hampshire	$2,259	40	Georgia	$1,919
8	Minnesota	$2,654	24	Virginia	$2,254	41	New Mexico	$1,905
9	Rhode Island	$2,627	25	Florida	$2,211	42	Alabama	$1,897
10	Nevada	$2,552	26	Vermont	$2,182	43	South Carolina	$1,891
11	Massachusetts	$2,550	27	Indiana	$2,170	44	West Virginia	$1,882
12	Washington	$2,496	28	North Carolina	$2,155	45	Idaho	$1,876
13	Arizona	$2,486	29	Maine	$2,106	46	Oklahoma	$1,835
14	Illinois	$2,477	30	North Dakota	$2,104	47	Louisiana	$1,827
15	Colorado	$2,413	31	Wyoming	$2,090	48	South Dakota	$1,820
16	Pennsylvania	$2,412	32	Nebraska	$2,084	49	Arkansas	$1,676
17	Wisconsin	$2,404	33	Utah	$2,052	50	Mississippi	$1,629

Recent Changes In Employment Levels: Using information from the Bureau of Labor Statistics, Steven Gold looked at employment in "What Has Happened To Government Employment In The Past Year." His paper, published by the Center for the Study of the States (411 State St., Albany, NY 12203) finds governments increasing employment from June of 1990 to June of 1991. Local employment rose 2.1% while state employment increased 1.3%.

There were sharp drops reported for a few state governments: Massachusetts (-6.0%), New York (-4.3%), Maine (-3.7%), Vermont (-3.5%), and Rhode Island (3.3%). There were also large increases led by Nevada (7.4%), South Carolina (6.9%), and Florida (5.8%).

TECHNICAL NOTES

Revenue Estimates: The outlying values in Tables 3 and 4 aren't all easily explained, but some are for reasons noted in the text and special cases noted here. The extreme overestimate of New York income tax probably is a misreporting by New York or misreading by **Reports** of accounting for that part of revenues included in one year and in a separate fund in the other. New Jersey errors are likely to be larger than those of other states because of extensive changes in the taxes involved. A large overestimate in income taxes in Connecticut is more plausible than other states because during FY 1991 the tax excluded relatively stable wages and salaries, so only dividends, interest, and capital gains were included. Virginia errors in FY 1991 estimating should be larger because its biennial budget cycle means its estimates were prepared a year sooner than those of other states. New Mexico's errors are implausible unless there was a major tax law or accounting change not reported. Misguessing the state's economy will produce errors in the same direction and of the same magnitude for sales and income taxes. New Mexico made the largest *under*estimate in the nation for sales tax and the fifth highest *over*estimate for the income tax.

Discrepancies In Reported Tax Increases: There are significant discrepancies in the executive and legislative reports of tax increases, such as those summarized in Table 7. Of course, underlying the differences in summary totals are differences in reporting for individual states. The differences arise: (1) from differences in estimates and estimating concepts in individual states and (2) from conceptual differences in how the two organizations calculate tax increases. One example is a sales tax increase effective the first day of a fiscal year that will, say, cause $100 million in added collections of which $85 million will occur in the new fiscal year and $15 million in the next. A state with full accrual accounting would say the tax raised $100 million. A cash accounting state would say $85 million. Most of the prior surveys would say $100 million on a full year implementation basis. Another example is renewal of a tax scheduled to expire, which some count as an increase and some don't.

Table A-1: Percentage Change In FY 1991 Spending

State	El. & Sec. Education	Higher Education	Cash Assistance	Medicaid	Corrections	Total
UNITED STATES	5.7%	5.6%	6.7	20.9	11.4	7.3
Alabama	6.4	7.9	-12.5	36.3	14.9	8.0
Alaska	4.0	3.9	11.7	36.7	10.9	6.3
Arizona	7.7	8.8	14.5	31.5	5.4	14.8
Arkansas	4.2	1.8	19.7	3.8	9.0	4.7
California	3.6	9.6	6.0	17.1	15.8	6.9
Colorado	7.0	-5.1	5.9	19.6	8.8	4.7
Connecticut	-7.0	7.2	15.4	30.6	30.5	3.9
Delaware	4.4	2.7	12.5	20.0	5.9	1.9
Florida	4.9	11.2	20.6	34.0	14.2	17.3
Georgia	2.3	-0.2	18.1	40.2	-9.2	4.3
Hawaii	10.1	8.1	9.5	3.1	10.0	3.9
Idaho	14.7	17.3	0.0	29.5	26.7	11.4
Illinois	2.3	3.7	5.5	13.4	13.3	8.0
Indiana	7.4	7.3	12.2	20.3	43.0	10.2
Iowa	10.0	11.3	-2.1	15.5	15.0	4.9
Kansas	1.3	5.0	-8.8	23.6	16.1	7.1
Kentucky	18.6	13.4	15.5	27.0	17.8	16.3
Louisiana	6.3	10.0	7.8	22.0	10.4	14.9
Maine	7.7	5.2	-5.4	10.8	-3.4	6.1
Maryland	6.4	5.8	13.0	4.9	1.8	1.3
Massachusetts	-14.5	-9.6	6.4	12.2	6.4	-0.7
Michigan	5.9	6.0	-8.6	-9.9	-10.3	1.4
Minnesota	26.5	8.2	19.4	16.3	14.1	11.3
Mississippi	2.6	5.5	4.2	12.5	17.1	13.1
Missouri	4.0	3.1	11.0	45.9	8.2	5.3
Montana	28.5	4.1	0.0	4.1	7.4	12.9
Nebraska	79.3	14.5	7.4	12.4	32.7	24.3
Nevada	n/a	n/a	n/a	n/a	n/a	n/a
New Hampshire	6.7	2.3	31.8	17.8	10.7	2.7
New Jersey	2.9	-5.7	8.8	17.3	17.0	4.0
New Mexico	7.8	6.0	22.7	18.4	2.0	-0.6
New York	1.0	-0.7	10.5	20.2	3.9	2.6
North Carolina	5.5	0.4	-28.1	15.6	2.0	7.4
North Dakota	5.8	-11.0	10.0	6.8	14.3	-17.2
Ohio	5.7	3.4	10.4	20.3	14.2	8.0
Oklahoma	20.1	5.1	7.6	10.1	14.1	10.5
Oregon	9.1	16.5	13.3	44.3	48.0	8.3
Pennsylvania	5.9	6.3	10.1	48.7	18.9	10.2
Rhode Island	-15.3	-9.0	21.9	16.1	13.2	-0.3
South Carolina	4.1	20.0	8.8	77.0	6.2	7.7
South Dakota	7.9	6.4	0.0	8.9	14.3	10.6
Tennessee	3.2	-2.5	19.0	23.3	3.7	6.0
Texas	12.2	5.9	21.1	34.5	21.5	11.1
Utah	10.1	8.8	8.7	18.8	21.5	11.1
Vermont	7.5	-1.7	25.0	31.7	7.4	3.0
Virginia	5.5	3.6	6.8	27.7	14.9	4.8
Washington	12.7	7.0	6.1	17.7	11.1	17.9
West Virginia	16.2	11.7	3.2	3.6	12.0	10.5
Wisconsin	6.9	0.7	0.0	8.7	89.7	8.4
Wyoming	-9.7	8.0	0.0	-13.6	17.4	-0.6